



International  
Ethics Standards  
Board for Accountants

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**Meeting Location:** IFAC Offices, New York, USA

**Meeting Date:** June 18-20, 2012

## Review of Part C of the Code

### Objective of Agenda Item

The IESBA has determined that as part of informing the development of its next Strategy and Work Plan, it should examine whether recent accounting irregularities reveal ethical implications for professional accountants in business (PAIBs) and whether Part C of the Code, which (along with Part A) establishes ethical standards for PAIBs, should be strengthened to provide more guidance and support for PAIBs. This paper reports the work and preliminary recommendations of the Part C working group<sup>1</sup>. Based on the discussion at the Board's June meeting, the working group will plan to provide a final report with recommendations to the Board at its next meeting.

### Background

The working group was organized to analyze reported accounting irregularities at certain companies and determine whether Part C should be strengthened to better promote ethical behavior by PAIBs. Based on its analysis, the working group would make recommendations about issues that merit the Board's attention in Part C. As part of its effort, the working group undertook an informal survey of a number of IFAC member bodies whose memberships comprise a large number of PAIBs, including member bodies from both developed and developing nations. The survey attempted to identify the types of ethical issues and problems encountered by the member bodies' PAIBs. The working group also considered whether additional guidance might be provided other than (or in addition to) changes to the Code itself.

The working group has had two teleconferences to consider the issues and to formulate its preliminary views and recommendations. While mindful of its main charge by the Board, which is to determine whether accounting irregularities at certain companies warrant improvements to Part C, its discussions were organized around the following topics:

- areas already addressed in Part C that might be enhanced, particularly in light of findings regarding accounting irregularities;
- areas not currently in Part C that might be addressed to respond to the findings regarding accounting irregularities; and

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<sup>1</sup> Jim Gaa (Chair), Alice McCleary, Lisa Snyder (Technical adviser), Ian Rushby (PAIBC), Larry Kean (SME).

- the form that any additional guidance might take if not part of Part C.

The working group reviewed the responses from the informal survey, and conducted its own analysis of the Code. Based on the survey responses and its own analysis, the working group has identified a number of areas where further development of the Code might be considered. The working group is recommending two primary and interrelated issues for consideration of the Board in the next work plan. The working group also notes three additional issues that may merit the Board's attention when time and resources permit.

To ensure the working group received broad input, Ian Rushby and Larry Kean were invited to join the working group. Ian Rushby is a member of the IFAC PAIB Committee and formerly held a number of senior PAIB roles within BP plc. Larry Kean is Secretary & Treasurer, A&A Manufacturing Co. He was also a member of the IESBA SME/P working group.

Appendices 2 and 3 include the text of relevant parts of Part C referred to in this paper.

## **Working Group's Research**

### *Accounting Irregularities*

A brief review of recent major accounting irregularities reported in the media shows that they tend to focus on illegal acts (i.e., those that violate a law or regulation), rather than acts that are (or may be) legal but are unethical. Irregularities that attract media attention typically produce numerous news articles and editorials, and documentation of and arguments about any fraud or complex financial accounting and reporting issues. The common themes are that such irregularities are generally orchestrated by senior management, who may include PAIBs.

Less attention is given in the media to the ethical issues, particularly the pressure faced by PAIBs to commit illegal or unethical acts. Cases where senior management were prosecuted reveal a number of issues relating to professional accountants who are subordinates, and take instructions from senior management. Examples are typically cases where judgment is involved and the PAIB becomes aware that at some point the line between legal and illegal was crossed, e.g., reserves that move from appropriate to inappropriate in order to achieve targets.

Accounting irregularities that are legal but unethical also create challenges for PAIBs. For example, one company used complex financial instruments that some argued obscured, and potentially misled financial statement users about, the capital structure and risk borne by the company. The working group is not aware of any prosecutions to date. However, the public attention given to the situation indicates that the financial reporting involved is generally considered by third parties to be misleading and therefore unethical.

Recent cases of alleged payment of bribes to officials reveals the importance of improved guidance on PAIBs' responsibilities in relation to any so-called "facilitation payments" that are common in many jurisdictions. Moreover, where such payments are common, the challenge will be to determine how guidance for PAIBs would operate in those jurisdictions.

### *Survey of member bodies*

A limited and informal survey was conducted of member bodies, in various parts of the world including developing countries, that have a large number of PAIBs as members, in order to determine what issues and problems their PAIBs encounter in practice. These are summarized:

Regarding the number and significance of ethical matters on which PAIBs contact their member body's ethics help line:

- The number of ethical queries received by member bodies from PAIBs is insignificant compared with those from practitioners.
- The only significant recurring issue was being pressured by those charged with governance or supervisors into reporting misleading information. This matter was reported by most survey respondents.

Some member bodies provide guidance in addition to that contained in the Code to support PAIBs. Amendments to Part C itself were limited but included:

- Guidance to elaborate on 100.18 (ethical conflicts resolution)
- Additions to 320.2 (financial statements presented in accordance with applicable financial reporting standards).

Other examples of additional support to PAIBs included:

- Material on disclosing confidential information and whistleblowing.
- Additional concept of "selflessness" in the public sector.
- The most significant additional content provided by member bodies to PAIBs is case studies, in particular from the UK and Australia. 62 case studies have been found.
- Mandatory training on ethics for PAIBs.

### **Preliminary Recommendations**

In recognition of the competing demands on the Board's time and other resources, the preliminary recommendation of the working group is that the IESBA consider two major and interconnected issues in its next Strategy and Work Plan.

First is the responsibility of PAIBs to produce financial reports that are faithful representations of the economics of transactions and not be associated with misleading information and reports.

Second is the pressure on PAIBs from superiors to violate laws or ethical standards. The working group believes that this problem has two aspects that could be addressed: how a PAIB should deal with pressure from superiors and other sources, and guidance for PAIBs who may pressure subordinates and others (such as internal and external auditors).

The two issues are linked in two ways. When PAIBs accede to pressure to prepare financial reports that are misleading, the reports are not faithful representations of the economics of the transactions being reported. Second, the guidance on these issues is contained primarily in sections 300, 310 (i.e., the current version, before the ED "Proposed Changes to the Code of

Ethics for Professional Accountants Addressing Conflicts of Interest”, 320, and 340. It may not be sufficient or structured in a way that best aids PAIBs in recognizing and dealing with pressure. For Board members’ convenience in considering the coverage of these issues in the Code (including changes already proposed by the Suspected Illegal Acts Task Force and by the Board in the Conflicts of Interest project), Appendices 2 and 3 contain the current and proposed text of the Code relating to these two issues.

The working group has discussed, but has not developed a view on whether additional guidance should be through the code or through a different mechanism.

*Responsibilities of PAIBs to Produce Relevant and Faithfully Representative Depictions*

According to the Conceptual Framework of the International Accounting Standards Board and the Financial Accounting Standards Board, financial reports should be useful to current and potential investors and creditors. Usefulness requires that information be relevant (capable of making a difference to the users of the information). In addition, information “must faithfully represent the phenomena that it purports to represent. To be a perfectly faithful representation, a depiction would have three characteristics. It would be complete, neutral, and free from error.”<sup>2</sup> For Board members’ convenience, Appendix 1 contains excerpts from the IASB/FASB Conceptual Framework on Financial Reporting.

The IESBA Code mentions a PAIB’s responsibility to provide representationally faithful information only briefly in two places: indirectly in paragraph 110.1 (“Integrity also implies fair dealing and truthfulness”) and in 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.”) Related to this responsibility, 320.2 states that financial reports shall be prepared in accordance with applicable financial reporting standards and 320.3 provides guidance on recordkeeping. The IESBA may wish to consider whether the Code could provide more guidance to PAIBs on the meaning of faithful representation.

The Code (including already proposed changes) also addresses a PAIB’s responsibility not to be associated with misleading reports. This occurs in a number of different places and contexts: 110.2, 300.10, and 310.2 (which has been proposed for deletion in the project on Conflicts of Interest). In addition, the Suspected Illegal Acts Task Force and the Board in the Conflicts of Interest project have proposed changes to 300.6 and 320.4. (Changes to 320.5 and 320.6 are editorial in nature.) It should be noted that in the Conflicts of Interest project, the paragraphs in the current version of Section 310 would be deleted because they do not involve a conflict of interest, and because the issues addressed in them are covered in other sections of Part C. The Board did not make any judgment about the adequacy of the other sections when it requested that the Conflicts of Interest Task Force work on consequential changes to 320 and 340 (as are contained in the Exposure Draft).

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<sup>2</sup> <http://www.ifrs.org/NR/rdonlyres/0BD5A2FE-1659-44D1-9074-FE07E4459E6D/0/ConceptualFW2010vb.pdf>

Paragraph 320.1 requires information to be presented “fairly, honestly and in accordance with relevant professional standards so that the information will be understood in its context.” Thus, a PAIB has a responsibility to prepare financial statements in accordance with GAAP and use professional judgment in determining that the information will be understood in the context in which it is presented. However, circumstances may exist where GAAP allows a presentation that does not reflect the economics of the transaction and would thus be misleading. The language in 320.1 could be interpreted as establishing a second test; that is, that the information is presented “fairly” and “honestly.” The Code does not expand on the meaning of fairly and honestly in this context. It may be helpful for PAIBs to understand whether the Code intends for a second test to apply and if so how it should be applied. The working group's preliminary recommendation is that the Code clarify the intent of the requirement that information be presented fairly and honestly. Specifically, 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, financial position and results of operations, that is not fair and honest in the circumstances.

Accounting irregularities may involve earnings management, such as arrangements to move material liabilities off balance sheet in accordance with GAAP. Regulators or third parties may consider the accounts to be misleading even though the financial statements are in accordance with GAAP. A PAIB in this case is faced with the dilemma that the financial statements may be misleading even though they do not violate applicable financial reporting standards. The Code could provide guidance on how PAIBs should respond to such situations.

Earnings management is an important part of faithful representation but the extant code makes no reference to it. It has both positive and negative connotations and ranges from acceptable to unacceptable. There are many definitions of earnings management. They are variants of each other, in that there is a focus on it as a form of strategic behavior. For example, earnings or balance sheet numbers are presented in a way, in order to produce a predetermined result, such as earnings that meet analysts' forecasts or that will produce a bonus for management, or allow the payment of dividends. Many of the definitions also build in the idea that earnings management is unethical, rather than defining it in a way that is ethically neutral, to allow for the possibility that earnings management may be ethically acceptable in some circumstances and not acceptable in other circumstances.

Some earnings management is illegal, but most is by design legal (i.e., not in violation of GAAP), and the ethical status of legal earnings management is controversial. For example, an academic survey of 400 executives<sup>3</sup> indicates that almost all businesses undertake earnings management (and often do so even when it is costly to the organization), but do so without violating any laws, regulations, or GAAP.

The Code does not provide guidance on distinguishing acceptable and improper earnings management. Because the credibility of financial reporting is central to investor protection, the working group recommends that the Board provide guidance on earnings management, especially if this term is included in the proposed paragraph 300.6 (responding to a suspected

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<sup>3</sup> [http://faculty.fuqua.duke.edu/~charvey/Research/Working\\_Papers/W73\\_The\\_economic\\_implications.pdf](http://faculty.fuqua.duke.edu/~charvey/Research/Working_Papers/W73_The_economic_implications.pdf)

illegal act). This would also be contained in Section 320, building on 320.1-320.3, and Section 300, amended to address the ethical issue. Further detailed guidance could be provided in relation to recommended revisions to Sections 320 and 340 (below).

*Pressure by Superiors and Others to Engage in Unethical or Illegal Acts*

Section 360, currently under consideration by the IESBA, focuses on suspected illegal acts. Except for a proposed change to paragraph 300.6, the proposed guidance does not address how a PAIB should deal with the unethical acts of others, and does not deal with pressures to engage in illegal or unethical acts. The survey of member bodies conducted by the working group reveals that the most common inquiry they receive from PAIBs concerns pressure to engage in unethical or illegal acts. Currently, guidance on this matter is contained in Sections 310 (the current version), 320.5-320.8, and 340 (sections relevant to these matters are reproduced in Appendix 3). The working group recommends that this guidance be consolidated and developed further in Section 340. In addition, it believes that pressures on PAIBs may come from superiors who are also PAIBs, and that the Code should address the responsibilities of superior PAIBs towards others in the context of illegal and unethical acts.

The working group is of the view that Section 340 is too narrowly described. First, although many PAIBs are involved in work that may indirectly feed into the group financial statements and other reports, not all are directly involved with financial statements of companies in which they have a financial interest and can influence the preparation of those financial statements. For example, many PAIBs will work at a subsidiary level or with management accounts and not in financial reporting in divisional or head offices. Second, the working group is of the view that pressure to improperly influence earnings results is as likely to be the result of the corporate culture, cajoling, bullying and threats of job loss as personal financial gain (which is addressed in Section 340). Third, the motivations created by intimidation threats are in Section 320. The Task Force believes that the positive motivations in Section 340 could be expanded beyond financial interests and that these are closely linked to the pressure to act inappropriately in Section 320. Combining these threats under one heading may make the Code clearer.

In addition to providing guidance to subordinate PAIBs in responding to inappropriate pressure, the Code could include guidance for those PAIBs who may exert the pressure. Paragraph 300.5 refers to the importance of encouraging an ethics-based culture, but there is no other guidance requiring a senior PAIB not to inappropriately pressure subordinates.

Part C focuses on the pressure on subordinates to commit illegal or unethical acts, but could also address the fact that a PAIB may be both a superior (exerting pressure on subordinates) and a subordinate on whom pressure is being exerted. An accounting irregularity may be accomplished with the knowing or unknowing support of a subordinate, who may be pressured to act in accordance with the instructions of the superior. Guidance similar to the escalation process in proposed Section 360 (illegal acts) may help the PAIB. In addition, guidance to PAIBs who have subordinates (whether they are PAIBs or not) may be helpful in dealing with the issue of pressure to commit illegal and unethical acts.

## **Other Matters**

As noted above, the working group has identified a number of matters that the IESBA could address in respect of Part C but is tentatively recommending what it considers to be the two most important issues for the IESBA's attention:

- responsibility for faithful representation of financial information; and
- dealing with pressure to act unethically.

The IESBA may wish to be aware of some of the other important issues that were considered in selecting the most important.

### *Receipts and Offers of Items of Value*

This is a challenging and perennial problem area for PAIBs, especially in the context of an international code of ethics and of organizations operating across jurisdictional boundaries. Section 350 (Inducements) covers both receipts and offers of items of value by PAIBs, ranging from token gifts to customary "facilitation payments" to bribery. Section 350 might be clarified and expanded to provide further guidance, particularly with respect to cultural differences regarding items of value.

### *Whistle Blowing*

Whistle blowing is a matter of general concern and has been raised in discussion of the Suspected Illegal Acts project. The Code provides no guidance on this difficult issue. Some member bodies have provided guidance to business members on whistle blowing. The IESBA might consider reviewing this guidance with the intention of distributing it more widely.

### *Responsibility of PAIBs to Advance the Legitimate Objectives of the Employing Organization*

The responsibility of PAIBs to advance the legitimate objectives of the employing organization is stated in Paragraphs 300.4 and 300.10. They do not explicitly address two related responsibilities: not to advance the illegitimate interests of the employing organization, and not to advance the illegitimate interests of others (such as superiors and fellow employees). This could be addressed in Section 300.

The responsibility for leadership by senior PAIBs is discussed in Paragraph 300.5. It discusses the importance of encouraging an ethics-based environment, which is important as a general obligation. But it does not include guidance about this. This matter was raised in a number of survey responses, i.e., that PAIBs are regularly pressured to engage in unethical (and even illegal) behavior, and is partially addressed in the section above about pressure on PAIBs to commit illegal and unethical acts.

## **Summary of Working Group's Preliminary Recommendations**

The working group is of the view that Part C does not require a major review. However, some of its content could be re-structured and developed further, to provide additional guidance. It recommends that priority be given to Sections 320 and 340.

The working group considered Part C in its entirety and summarizes briefly below its review of each section:

The working group did not consider Section 310 (Conflicts of Interest) because it is currently the subject of another task force.

The following is a summary of the working group's tentative recommendations about the proposed development of Part C of the Code.

Section 300: A number of changes are recommended. Some of them follow from changes to other sections, and others are intended to clarify the current language.

Section 310 (the extant version): All paragraphs of the current Section 310 have been removed in the exposure draft. The working group recommends that relevant paragraphs relating to pressures on PAIBs to act unethically or illegally be moved to Section 340.

Section 320: Change the focus of Section 320 to the responsibility of PAIBs to produce (and be associated with) "faithfully representative depictions," and not to be associated with misleading information and reports, whether or not external (such as audited financial statements or internal reports).

Section 330: This section is appropriate but the Board could consider reducing it and including it in Section 300.

Section 340: This section could be changed to address the pressures facing PAIBs to engage in illegal or unethical acts. This would involve moving and adapting portions of Sections 310 (the extant version) and 320.

Section 350: This section covers problems relating to "side-payments," receiving "offers" of items of value (including those received as gifts) (350.1-350.4), and providing items of value to others (350.5-350.8). This is a challenging area, especially in cross-cultural contexts, and this section could be clarified and could provide additional guidance.

The recommendations have focused on changes to the Code but the working group recognizes that guidance might be more appropriately addressed through Q&As, case studies, etc.

#### **Action Requested**

IESBA members are asked:

1. To comment on the working group's analysis and tentative recommendations
2. To consider whether there are other issues they would like the working group to examine.



## **Appendix 1**

### **Excerpts from IASB/FASB Conceptual Framework for Financial Reporting. Faithful Representation**

QC12. Financial reports represent economic phenomena in words and numbers. To be useful, financial information not only must represent relevant phenomena, but it also must faithfully represent the phenomena that it purports to represent. To be a perfectly faithful representation, a depiction would have three characteristics. It would be complete, neutral, and free from error. Of course, perfection is seldom, if ever, achievable. The Board's objective is to maximize those qualities to the extent possible.

QC13. A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations. For example, a complete depiction of a group of assets would include, at a minimum, a description of the nature of the assets in the group, a numerical depiction of all of the assets in the group, and a description of what the numerical depiction represents (for example, original cost, adjusted cost, or fair value). For some items, a complete depiction also may entail explanations of significant facts about the quality and nature of the items, factors and circumstances that might affect their quality and nature, and the process used to determine the numerical depiction.

QC14. A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasized, deemphasized, or otherwise manipulated to increase the probability that financial information will be received favorably or unfavorably by users. Neutral information does not mean information with no purpose or no influence on behavior. On the contrary, relevant financial information is, by definition, capable of making a difference in users' decisions.

QC15. Faithful representation does not mean accurate in all respects. Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.

QC16. A faithful representation, by itself, does not necessarily result in useful information. For example, a reporting entity may receive property, plant, and equipment through a government grant. Obviously, reporting that an entity acquired an asset at no cost would faithfully represent its cost, but that information probably would not be very useful. A slightly more subtle example is an estimate of the amount by which an asset's carrying amount should be adjusted to reflect an impairment in the asset's value. That estimate can be a faithful representation if the reporting entity has applied properly an appropriate process, described properly the estimate, and explained any uncertainties that significantly affect the estimate. However, if the level of uncertainty in such an estimate is sufficiently large, that estimate will not be particularly useful. In other words, the relevance of the asset being faithfully represented is questionable. If there is no alternative representation that is more faithful, that estimate may provide the best available information.

## Appendix 2

### **Responsibility to produce reports that are representationally faithful / Responsibility not to produce reports that are false or misleading**

#### **EXCERPTS FROM THE IESBA CODE AND PENDING PROPOSALS**

110.1 The principle of integrity imposes an obligation on all professional accountants to be straightforward and honest in all professional and business relationships. Integrity also implies fair dealing and truthfulness.

110.2 A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the professional accountant believes that the information:

- (a) Contains a materially false or misleading statement;
- (b) Contains statements or information furnished recklessly; or
- (c) Omits or obscures information required to be included where such omission or obscurity would be misleading.

When a professional accountant becomes aware that the accountant has been associated with such information, the accountant shall take steps to be disassociated from that information.

310.2 [deleted from the Code in the exposure draft of section 310] As a consequence of responsibilities to an employing organization, a professional accountant in business may be under pressure to act or behave in ways that could create threats to compliance with the fundamental principles. Such pressure may be explicit or implicit; it may come from a supervisor, manager, director or another individual within the employing organization. A professional accountant in business may face pressure to:

- Act contrary to law or regulation.
- Act contrary to technical or professional standards.
- Facilitate unethical or illegal earnings management strategies.
- Lie to others, or otherwise intentionally mislead (including misleading by remaining silent) others, in particular:
  - o The auditors of the employing organization; or
  - o Regulators.
- Issue, or otherwise be associated with, a financial or non-financial report that materially misrepresents the facts, including statements in connection with, for example:
  - o The financial statements;
  - o Tax compliance;
  - o Legal compliance; or
  - o Reports required by securities regulators.

310.10 [deleted from the Code in the exposure draft of section 310] When furthering the legitimate goals and objectives of their employing organizations, professional accountants in business may promote the organization's position, provided any statements made are neither false nor misleading. Such actions generally would not create an advocacy threat.

320.1 Professional accountants in business are often involved in the preparation and reporting of information that may either be made public or used by others inside or outside the employing organization. Such information may include financial or management information, for example, forecasts and budgets, financial statements, management's discussion and analysis, and the

management letter of representation provided to the auditors during the audit of the entity's financial statements. 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 A professional accountant in business who has responsibility for the preparation or approval of the general purpose financial statements of an employing organization shall be satisfied that those financial statements are presented in accordance with the applicable financial reporting standards.

320.3 A professional accountant in business shall take reasonable steps to maintain information for which the professional accountant in business is responsible in a manner that:

- (a) Describes clearly the true nature of business transactions, assets, or liabilities;
- (b) Classifies and records information in a timely and proper manner; and
- (c) Represents the facts accurately and completely in all material respects.

#### **Current Task Forces, relevant excerpts [added text is underlined]**

##### **From Suspected Illegal Acts Task Force:**

300.6 A professional accountant in business shall not knowingly engage in any business, occupation, or activity, such as persistent aggressive earnings management or balance sheet valuations, that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, impairs or might impair integrity, objectivity or the good reputation of the profession and as a result would be incompatible with the fundamental principles.

##### **From Conflicts of Interest Task Force Exposure Draft**

320.4 A professional accountant in business shall not knowingly be associated with any financial information or financial statements that the professional accountant believes:

- (a) Contains a materially false or misleading statement;
- (b) Contains statements or information furnished recklessly; or,
- (c) Omits or obscures information required to be included where such omission or obscurity would be misleading.

320.5 Threats to compliance with the fundamental principles, for example, self-interest or intimidation threats to integrity, objectivity or professional competence and due care, are created where a professional accountant in business is pressured (either externally or by the possibility of personal gain) to prepare or report information in a misleading way or to become associated with misleading information through the actions of others. [editorial change]

340.3 A professional accountant in business shall not manipulate information for personal gain or for the financial gain of others. [moved from end of paragraph] The more senior the position that the professional accountant in business holds, the greater the ability and opportunity to influence financial reporting and decision making and the greater the pressure there might be from superiors and peers to manipulate information. In such situations, the professional accountant in business shall be particularly alert to the principle of integrity, which imposes an obligation on all professional accountants to be straightforward and honest in all professional and business relationships.

### **Appendix 3**

#### **Leadership, and Pressure and Incentives to Commit Illegal or Unethical Acts**

##### **EXCERPTS FROM THE IESBA CODE AND PENDING PROPOSALS**

100.5 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.

100.12 Threats may be created by a broad range of relationships and circumstances. When a relationship or circumstance creates a threat, such a threat could compromise, or could be perceived to compromise, a professional accountant's compliance with the fundamental principles. A circumstance or relationship may create more than one threat, and a threat may affect compliance with more than one fundamental principle. Threats fall into one or more of the following categories:

- (a) Self-interest threat – the threat that a financial or other interest will inappropriately influence the professional accountant's judgment or behavior;
- (b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made or service performed by the professional accountant, or by another individual within the professional accountant's firm or employing organization, on which the accountant will rely when forming a judgment as part of providing a current service;
- (c) Advocacy threat – the threat that a professional accountant will promote a client's or employer's position to the point that the professional accountant's objectivity is compromised;
- (d) Familiarity threat – the threat that due to a long or close relationship with a client or employer, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
- (e) Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the professional accountant.

120.1 The principle of objectivity imposes an obligation on all professional accountants not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others.

300.4 A professional accountant in business has a responsibility to further the legitimate aims of the accountant's employing organization. This Code does not seek to hinder a professional accountant in business from properly fulfilling that responsibility, but addresses circumstances in which compliance with the fundamental principles may be compromised.

300.5 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.

300.12 Examples of circumstances that may create intimidation threats for a professional accountant in business include:

- Threat of dismissal or replacement of the professional accountant in business or a close or immediate family member over a disagreement about the application of an accounting principle or the way in which financial information is to be reported.
- A dominant personality attempting to influence the decision making process, for example with regard to the awarding of contracts or the application of an accounting principle.

300.14 Safeguards in the work environment include:

- .....
- Leadership that stresses the importance of ethical behavior and the expectation that employees will act in an ethical manner.
- Policies and procedures to implement and monitor the quality of employee performance.
- Timely communication of the employing organization's policies and procedures, including any changes to them, to all employees and appropriate training and education on such policies and procedures.
- Policies and procedures to empower and encourage employees to communicate to senior levels within the employing organization any ethical issues that concern them without fear of retribution.

310.2 [deleted from the Code in the exposure draft of section 310] As a consequence of responsibilities to an employing organization, a professional accountant in business may be under pressure to act or behave in ways that could create threats to compliance with the fundamental principles. Such pressure may be explicit or implicit; it may come from a supervisor, manager, director or another individual within the employing organization. A professional accountant in business may face pressure to:

- Act contrary to law or regulation.
- Act contrary to technical or professional standards.
- Facilitate unethical or illegal earnings management strategies.
- Lie to others, or otherwise intentionally mislead (including misleading by remaining silent) others, in particular:
  - o The auditors of the employing organization; or
  - o Regulators.
- Issue, or otherwise be associated with, a financial or non-financial report that materially misrepresents the facts, including statements in connection with, for example:
  - o The financial statements;
  - o Tax compliance;
  - o Legal compliance; or
  - o Reports required by securities regulators

320.4 Threats to compliance with the fundamental principles, for example, self-interest or intimidation threats to objectivity or professional competence and due care, are created where a professional accountant in business is pressured (either externally or by the possibility of personal gain) to become associated with misleading information or to become associated with misleading information through the actions of others.

320.5 The significance of such threats will depend on factors such as the source of the pressure and the degree to which the information is, or may be, misleading. The significance of the threats shall be evaluated and safeguards applied when necessary to eliminate them or reduce them to an acceptable level. Such safeguards include consultation with superiors within the employing organization, the audit committee or those charged with governance of the organization, or with a relevant professional body.

320.6 Where it is not possible to reduce the threat to an acceptable level, a professional accountant in business shall refuse to be or remain associated with information the professional accountant determines is misleading. A professional accountant in business may have been unknowingly associated with misleading information. Upon becoming aware of this, the professional accountant in business shall take steps to be disassociated from that information. In determining whether there is a requirement to report, the professional accountant in business may consider obtaining legal advice. In addition, the professional accountant may consider whether to resign.

340.1 Professional accountants in business may have financial interests, or may know of financial interests of immediate or close family members, that, in certain circumstances, may create threats to compliance with the fundamental principles. For example, self-interest threats to objectivity or confidentiality may be created through the existence of the motive and opportunity to manipulate price sensitive information in order to gain financially. Examples of circumstances that may create self-interest threats include situations where the professional accountant in business or an immediate or close family member:

- Holds a direct or indirect financial interest in the employing organization and the value of that financial interest could be directly affected by decisions made by the professional accountant in business;
- Is eligible for a profit related bonus and the value of that bonus could be directly affected by decisions made by the professional accountant in business;
- Holds, directly or indirectly, share options in the employing organization, the value of which could be directly affected by decisions made by the professional accountant in business;
- Holds, directly or indirectly, share options in the employing organization which are, or will soon be, eligible for conversion; or
- May qualify for share options in the employing organization or performance related bonuses if certain targets are achieved.

340.2 The significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. In evaluating the significance of any threat, and, when necessary, determining the appropriate safeguards to be applied to eliminate the threat or reduce it to an acceptable level, a professional accountant in business shall evaluate the nature of the financial interest. This includes evaluating the significance of the financial interest and determining whether it is direct or indirect. What constitutes a significant or valuable stake in an organization will vary from individual to individual, depending on personal circumstances. Examples of such safeguards include:

- Policies and procedures for a committee independent of management to determine the level or form of remuneration of senior management.
- Disclosure of all relevant interests, and of any plans to trade in relevant shares to those charged with the governance of the employing organization, in accordance with any internal policies.
- Consultation, where appropriate, with superiors within the employing organization.

- Consultation, where appropriate, with those charged with the governance of the employing organization or relevant professional bodies.
- Internal and external audit procedures.
- Up-to-date education on ethical issues and on the legal restrictions and other regulations around potential insider trading.

340.3 A professional accountant in business shall neither manipulate information nor use confidential information for personal gain.

**Current Task Forces, relevant excerpts [added text is underlined]**

**From Suspected Illegal Acts Task Force:**

300.5 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. Established ethics policies and whistle-blowing procedures that have been communicated to all employees may be useful to achieve the objective of establishing and maintaining an ethics-based culture. Such procedures help to deter malpractice and increase the likelihood of senior management being alerted to a problem in time to prevent serious damage.

320.5 Threats to compliance with the fundamental principles, for example, self-interest or intimidation threats to integrity, objectivity or professional competence and due care, are created where a professional accountant in business is pressured (either externally or by the possibility of personal gain) to prepare or report information in a misleading way or to become associated with misleading information through the actions of others. [editorial change]

340.3 A professional accountant in business shall not manipulate information for personal gain or for the financial gain of others. [moved from end of paragraph] The more senior the position that the professional accountant in business holds, the greater the ability and opportunity to influence financial reporting and decision making and the greater the pressure there might be from superiors and peers to manipulate information. In such situations, the professional accountant in business shall be particularly alert to the principle of integrity, which imposes an obligation on all professional accountants to be straightforward and honest in all professional and business relationships.