

Review of Part C of the Code

How the Project Serves the Public Interest

Over half of the world's professional accountants are professional accountants in business (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.

All organizations require relevant and reliable information in order to conduct their affairs. In addition, interested external parties (such as investors, suppliers, customers, employees, and government agencies) require relevant and reliable information to assess an organization's situation, in order to ensure accountability to them and for them to make decisions about the organization. In particular, enabling PAIBs to better deal with the issue of inappropriate pressure on them 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.

It is also in the public interest that PAIBs who are responsible for the preparation of such information do so honestly, and that the information they present is not false or misleading, or prepared or presented recklessly or negligently. The IESBA intends that Section 320 will provide more specific guidance for PAIBs who present information (a) for internal or external purposes, (b) that is financial or non-financial in nature, (c) and which might or might not be prepared in accordance with a reporting framework.

I. Presentation of Information (Section 320)

1. At its meeting in April 2014, the Board reviewed proposed revisions to Section 320.¹ The Board was generally supportive of the proposed changes to Section 320, and in particular tentatively supported Section 320 incorporating enhanced guidance to help PAIBs better understand their responsibilities relating to the fundamental principles when facing:
 - Misuse or abuse of discretion under the applicable reporting framework; and
 - Transaction-based misrepresentation.

MISUSE OF DISCRETION

2. At the April 2014 meeting, the Board tentatively agreed that the enhanced guidance in Section 320 should be kept at a high level and not be too detailed. Based on the two categories in paragraph 1 above, as were noted in the April 2014 issues paper, the Task Force proposes a paragraph that lists the following four ways in which discretion can be used to mislead, including one or two examples of each (see paragraph 320.3):

¹ Section 320, *Preparation and Reporting of Information*

- Determining estimates. For example over- or under-accruing for warranty expenses or changing amortization rates or useful lives or residual values of fixed assets in order to manipulate income.
 - Selecting a particular accounting method among two or more alternatives permitted under the applicable financial reporting framework. For example the selection of capitalization or depreciation methods, or selection of one method from among alternative revenue recognition methods in order to manipulate income.
 - Determining the timing of transactions. For example, timing revenue transactions in order to manipulate current income.
 - Determining the structuring of transactions. For example, structuring financing transactions in order to manipulate the statement of financial position or the cash flow statement.
3. In addressing these matters, the Task Force referred to a textbook that analyzes the quality of accounting.²

Matters for Consideration

1. Do Board members agree these categories and examples are useful and appropriate?
2. Are there other categories or examples where PAIBs use discretion to mislead that should be added to paragraph 320.3?

REQUIREMENTS OR GUIDANCE

4. The proposed wording presented to the Board in April 2014 contained 14 “shall” statements, which made the proposed Section appear to be very prescriptive. The Task Force has therefore reconsidered the approach to developing the guidance. The Task Force concluded that the requirement to prepare information in a fair and honest manner is the underlying principle and many of the other requirements could be drafted as guidance as to the meaning of “fair and honest.” The Task Force has therefore redrafted Section 320 to effect this change, with a focus on providing additional guidance to PAIBs.

CHANGES FROM EXTANT CODE

5. The Task Force was asked to explain what significant differences from the extant Section 320 have been made. The Task Force reviewed a detailed comparison of the extant and proposed wording. The Task Force concluded that in addition to a significant number of clarifications and other refinements, the major changes are as follows:
- Extant Section 320 includes a requirement to prepare information fairly and honestly but provides no guidance on how to do this. Proposed paragraph 320.2 includes an overarching requirement to record, maintain, prepare or present information in a manner that is fair and honest. This creates a broad principle that is supported by six bullets that provide guidance as to how this overarching principle may be achieved.

² *Financial Statement Analysis and Security Valuation* by Stephen Penman, pp 593-594

- Section 320 (effective July 1, 2014) includes three requirements in paragraphs 320.1-3 to maintain, prepare and present information. Paragraphs 320.4-7 (effective July 1, 2014) refer to threats and safeguards, but they address pressure to prepare misleading information. Pressure is now addressed in proposed Section 370³ and is therefore not addressed in the proposed Section 320.
 - Proposed paragraph 320.3 links the “fair and honest” requirement to the four ways in which discretion can be used to mislead while presenting the information in accordance with the applicable financial reporting framework.
 - Paragraph 320.7 (effective July 1, 2014) requires a PAIB under certain circumstances to take steps to disassociate from misleading information, but provides no guidance as to how a PAIB can disassociate. Proposed Section 320 includes two paragraphs (320.6 and 320.7) providing a process by which a PAIB can disassociate from such information.
 - Section 320 (effective July 1, 2014) does not address a benchmark to which the PAIB could refer when preparing information that is not subject to a reporting framework. Paragraph 320.4 provides guidance for the PAIB when preparing or presenting information such as pro forma reports, supplementary measures, budgets and forecasts that explains that it may be necessary for the PAIB to disclose relevant information as is necessary to enable those who may rely on such information to form their own judgments.
 - Paragraph 310.2⁴ (effective until July 1, 2014, after which it will be withdrawn) addresses pressure to engage in a variety of acts that breach the fundamental principles, including unethical or illegal earnings management, and lying or otherwise intentionally misleading others. The issues in this paragraph are addressed in Section 370 (pressure) and paragraphs 320.2 and 320.3 (unethical and illegal earnings management and intentionally misleading others, respectively). Actual or suspected Illegal earnings management will be covered by proposed Section 360.⁵
6. Amongst other matters, Board members raised the following issues on the proposed Section 320 at the April 2014 meeting.
7. It was suggested that the requirement to prepare information in accordance with the relevant reporting framework, which the Task Force had retained from the extant Code, should be deleted because it duplicates accounting standards. The Task Force believes that this requirement addresses an accountant’s responsibility to comply with professional standards and that to delete this requirement would weaken a paragraph of the Code that addresses an important matter of public interest. However, it has reduced the prominence of the requirement from being a separate paragraph to being bullet point guidance to explain the meaning of “fair and honest” in paragraph 320.2.
8. It was suggested that the requirement in respect of information other than that prepared in accordance with the relevant reporting framework could also be deleted. The Task Force believes

³ Proposed Section 370, *Pressure to Breach the Fundamental Principles*

⁴ Extant Section 310, *Potential Conflicts*

⁵ Proposed Section 360, *Responding to Non-compliance with Laws and Regulation*

that there is an absence of guidance on such matters and therefore it should be retained. However it did change it from a requirement to being a matter that is important. (See paragraph 320.2.)

9. There was a question as to whether paragraph 320.6 could provide a loophole for a PAIB to claim that compliance with the applicable financial reporting framework is misleading and therefore could use the Code to second guess the reporting framework. The Task Force interprets this comment to address whether the proposed Section 320 sets an alternative standard to the applicable financial reporting framework. Paragraph 320.2 precludes this. A PAIB who is not acting in good faith could intentionally present misleading information that does not violate the applicable financial reporting framework and claim that, in the PAIB's opinion, the Code justifies departure from the financial reporting standard. The Task Force believes that this circumstance would be addressed by the fundamental principle of integrity because the PAIB would be acting dishonestly.
10. There was a question as to whether it would be acceptable for a PAIB to account for a misleading structured transaction designed by others. Based on paragraph 110.2,⁶ the Task Force is of the view that if a PAIB believes a transaction to be misleading, he or she would be associated with it whether he or she was part of the decision-making process or merely accounted for it. It is also possible that a PAIB who, for example, records the transaction might not be knowingly associated with the misleading information, in which case paragraphs 110.2 and 320.3 do not apply. One of the principal changes proposed by the Task Force is to provide practical guidance as to how a PAIB can disassociate from misleading information. Paragraphs 320.6 and 320.7 provide the steps a PAIB can take in this situation.
11. There was a concern as to whether the requirement on the PAIB's "intentions" is enforceable and whether this could lead to the PAIB being second guessed by lawyers and regulators. The Task Force has focused the proposed Section 320 on principles and guidance rather than on prescriptive requirements. In addition, it believes that the enforceability of principles is a basic tenet of the Code.
12. It was suggested in previous Board discussions that the Task Force liaise with the International Accounting Standards Board (IASB) on the proposed changes to Section 320 because the Section overlaps with the requirements of accounting standards. The Task Force considered this suggestion and believes that liaison is not necessary because Section 320 is limited to ethical matters and not technical accounting matters. In addition, financial reporting standard setters work (with very few exceptions) on the assumption that professional accountants apply standards in good faith, and are intending to prepare and present high quality, non-misleading, information.

II. **Pressure to Breach the Fundamental Principles**

13. The Board raised the following issues on proposed Section 370 at its meeting in April 2014.

LANGUAGE OF THREATS AND SAFEGUARDS

14. Because of the diversity of views on the Board regarding whether or not proposed Section 370 should be drafted in the language of threats and safeguards, the Task Force re-considered the merits of both sides of the argument. It also noted that the subject of safeguards is a potential

⁶ Section 110, *Integrity*

project in the Board's proposed Strategy and Work Plan 2014-2018, reflecting partly a need to reconsider how safeguards should be used in the Code.

15. The following considerations have been offered for using the language of threats and safeguards in Section 370:
 - The Conceptual Framework applies to the whole Code and there should be no exceptions.
 - Extant Sections 310 and 320 (effective until July 1, 2014) use the language of threats and safeguards in addressing pressure.
 - The safeguards proposed by the Task Force in September 2013 were consistent with safeguards used in other parts of the Code and complied with the definition of safeguards in paragraph 100.13.⁷
16. The following considerations have been offered for not using the language of threats and safeguards in proposed Section 370:
 - While the conceptual framework underpins the whole Code, the “threats and safeguards” terminology does not operate well when addressing pressure because pressure is a circumstance and is beyond the PAIB’s control when he or she is not the source of the pressure. There would be little point in trying to “retrofit” the proposed Section into the threats and safeguard construct when PAIBs really are looking for practical guidance to assist them in dealing with the often difficult and stressful situation of pressure. The responsibility of senior PAIBs to implement safeguards will be addressed in the amendments to Section 300.⁸
 - Proposed Section 360 has not used the language of threats and safeguards, and respondents to the exposure draft of that proposed Section have not raised a concern about the absence of the threats and safeguards terminology in that Section. In terms of the structure of the Code, both Sections 360 and 370 can be considered to provide guidance in the context of paragraphs 100.19-100.24⁹ (effective July 1, 2014)
17. The Task Force considered the merits of both sides of the argument and strongly believes that the public interest would be better served by proposed Section 370 not being drafted using the threats and safeguards terminology, but drafted in a way that would be most likely to provide practical guidance to a PAIB facing pressure to breach the fundamental principles.
18. Although the proposed Section does not use the language of threats and safeguards, it does include a requirement to decline or discontinue the activity if the pressure cannot be alleviated or eliminated, and consideration, where necessary, of the PAIB’s continuing relationship with the employing organization.

⁷ Section 100, *Introduction and Fundamental Principles*

⁸ Section 300, *Introduction*

⁹ Paragraphs 100.19-24 deal with ethical conflict resolution.

Matters for Consideration

3. Do Board members agree that:
 - (a) Proposed Section 370 should not be drafted using the “threats and safeguards” language?
 - (b) The provisions in Section 370 are helpful guidance in implementing paragraphs 100.19-100.24?

REQUIREMENTS

19. A number of Board members did not support a requirement not to yield to pressure unless it is supported by practical guidance because it is a rhetorical statement or simply an instruction to maintain an ethical standpoint, rather than a prohibition. It was felt that practical guidance would be very difficult for this reason. It was suggested that “remain alert to” would be more helpful. It was also noted that any changes to this wording should not weaken the requirement.
20. The Task Force proposes to reword the requirement not to yield to pressure as follows (see paragraph 370.3):

When faced with pressure, the professional accountant shall not allow such pressure to result in a breach of the fundamental principles.
21. This avoids weakening a requirement which is fundamental to this section while limiting it to matters within the professional accountant’s personal responsibility.

DETERMINING WHETHER PRESSURE WOULD LEAD TO A BREACH

22. At the April 2014 Board meeting, it was questioned whether there is a connection between a breach of the fundamental principles and the factors the PAIB should consider in determining whether the pressure would lead to a breach. For example, the corporate culture of the organization is unrelated to whether there may be a breach of the fundamental principles, as this could occur in an ethical or unethical organization. The Task Force accepted that this was the case but believes that the perceived integrity of the organization and higher levels of management is a relevant factor for a PAIB to consider when assessing the nature of the pressure. The Task Force considered that the factors involving “expected repercussions” are not relevant in determining whether pressure would lead to a breach. These have therefore been deleted.
23. The Task Force considered the suggestion at the April 2014 Board meeting to combine the paragraph that helps a PAIB determine whether the pressure could lead to a breach and the paragraph that provides steps to address the pressure on the grounds that the distinction between the two paragraphs was arbitrary. On further reflection, the Task Force believes that the distinction remains appropriate but has clarified the wording of the two paragraphs (see paragraphs 370.6-7).

CREATING AN ETHICS-BASED CULTURE

24. A number of Board members were supportive of the wording suggesting how an organization can create an ethics-based culture as an action to mitigate the effects of inappropriate pressure. However, a Board member did not agree that more senior professional accountants may face greater pressure than juniors, although the consequences may be greater.

25. The Task Force proposes moving the paragraph on creating an ethics-based culture to Section 300 because it builds on paragraph 300.5 and because it is generally applicable to the PAIB environment and is not limited to pressure situations.
26. Changes to this paragraph will be presented to the Board at the October 2014 meeting when amendments to Sections 300, 310, 330¹⁰ and 340¹¹ will be proposed.

¹⁰ Section 330, *Acting with Sufficient Expertise*

¹¹ Section 340, *Financial Interests*