

**Revision of Part C Phase 2—Inducements Issues and Task Force Proposals****How the Project Serves the Public Interest**

A professional accountant in business (PAIB) may be offered an inducement with the intention of influencing the behavior of the accountant or obtaining an advantage from the accountant that would not have been attained without the inducement. Such actions might violate the legitimate objectives of the accountant's employing organization and could result in the accountant failing to comply with the fundamental principles of the Code. It is not in the public interest for an accountant to offer, solicit or accept inducements that could result in breaching the fundamental principles of the Code.

**Background**

1. At its September 2016 meeting, the IESBA considered a "[strawman](#)" detailing the Task Force's proposals for revising the provisions in the extant Section 250<sup>1</sup> relating to inducements. IESBA members generally approved of the revised structure in the strawman, and provided editorial and drafting suggestions. At its December 2016 meeting, the IESBA considered a [first read](#) of the proposed revised section. The feedback received was considered by the Task Force and is included in **Agenda Item 4-B**. The Task Force's proposals are drafted using the format and drafting conventions for the proposed restructured Code set out in the [agreed-in-principle text](#) for Phase 1 of the Structure of the Code project.

**The Use of "Inducements" as a Neutral Term**

2. The term "inducements" was used in the December 2016 proposed text as an overarching neutral term to include all gifts and hospitality. Some IESBA members felt that the term "inducement" was not neutral and suggested that the Task Force clarify its proposals to explain that not all gifts and hospitality should be considered inducements. Those members explained that there are situations where gifts and hospitality can be offered with no expectations of the professional accountant (PA). The manner in which the term "inducements" is used might also have implications on the proposed title of the section which as of the December 2016 draft was "Gifts, Hospitality and other Inducements".

**Task Force's Response**

3. The Task Force reconsidered the issue and concluded that "inducement" is a very abstract word which is not easily translated and often used in a context that implies a negative connotation. However, review of the term "inducements" in several dictionaries indicated that it is a collective term for different kinds of means, for example objects, situations or actions that are used to influence behavior, but not necessarily influence with an inappropriate intent. The Task Force is of the view that inducements can be used to improperly influence an individual's behavior, but can also encourage positive beneficial behaviors, for example an employer offering incentive programs to its employees.
4. The proposed text has been revised to clarify that the term "inducement" is being used as a neutral

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<sup>1</sup> Proposed restructured Code, Part 2 – Professional Accountants in Business Section 250, *Inducements* (Extant Part C – Professional Accountants in Business, Section 350, *Inducements*)

term. Further guidance in paragraph 250.5 A1 of agenda paper 4-B clarifies that depending on the circumstances in which the inducement is offered or received, it might affect the PA's ability to comply with the fundamental principles. Inducements such as gifts, hospitality, financial interest and compensation incentives should still be considered inducements, however the section focuses on inducements that influence behavior in a manner that might result in a breach of the fundamental principles.

5. The amendment allows the retention of the proposed title “Gifts, Hospitality and other Inducements” which conveys that there are situations that exist where gifts and hospitality can be offered or received without adversely influencing an individual's behavior.

### **Structure and Scope**

6. A few IESBA members suggested that the scope of the project should be clarified, in particular to explain whether it would provide additional guidance to explain how the section relates to illegal bribery and corruption.

### *Task Force's Response*

7. The Task Force considered that while its proposals do not provide guidance on how to deal with illegal acts, it includes a requirement in proposed paragraph R250.7 for PAs to obtain an understanding of relevant legal or regulatory provisions and comply with them. To further stress both the importance of this requirement and to clarify that section 250 focuses on the ethical dilemmas surrounding inducements and not on those relating to illegal bribery and corruption, the Task Force has revised the introductory paragraph in 250.3 by adding a reference to this requirement.

### **Matters for IESBA Consideration**

1. IESBA members are asked for views about the Task Force's revisions to its December 2016 proposals aimed at clarifying:
  - (a) The intended meaning of the term “inducement” and how it should be considered in the context of the proposed Section 250.
  - (b) The scope of the proposed Section 250.

### **Reasonable and Informed Third Party (RITP)**

8. The proposals presented at the December 2016 IESBA meeting included an alternative to the RITP test to evaluate whether the offering or accepting of an inducement is appropriate to account for the fact that perceptions might be held by those who do not meet the description of a RITP. During the IESBA discussion, it was felt that another threshold might be more appropriate with respect to perceptions about inducements where the disclosure of an inducement is publically available. However, the IESBA felt that the RITP test should be retained for evaluating whether an inducement is appropriate, as an alternative test would need to be established first.

### *Task Force's Response*

9. The Task Force has reconsidered the issue, noting that the matter of “anyone” forming a conclusion over whether an inducement is appropriate could essentially forbid any inducements, as the possibility exists that someone within the general public might regard even the smallest inducement

as being inappropriate. Having such an important test being based on individual perceptions would also complicate enforceability. The RITP test, however, is made from the perspective of an individual who evaluates all the relevant facts and circumstances that the PA knows, or could reasonably be expected to know, at the time the conclusions are made.

10. The Task Force thus aligned with the IESBA's views and concluded that the RITP test is relevant to Section 250. Also, a different test than the RITP test has not been established in the Code.

**Matter for IESBA Consideration**

2. IESBA members are asked for views on the Task Force's conclusion that the RITP test is relevant in Section 250.

**Intent Test**

11. At its December 2016 meeting, an IESBA member questioned whether the Task Force believed that the intent test continues to be appropriate and asked whether the Task Force had considered replacing the intent test with a more objective test that might make it possible to conclusively assess the intent of another individual in an objective manner.

*Task Force's Response*

12. The Task Force is of the view that another individual's intent can only be understood to a certain extent, and acknowledged the need for a degree of subjectivity in a principles-based Code. The need for consideration of this subjectivity is set out in proposed paragraphs R250.10<sup>2</sup> and R250.11<sup>3</sup> and is limited to matters that "the accountant has reason to believe" is the intent. The "intent test" can thus only be made objectively by considering the factors that are set out in paragraph 250.10 A1.
13. Also, the Task Force believes that an underlying intent test, although described in other words, is set out in the extant paragraph 350.2<sup>4</sup> and as such, is already being applied by PAs.

**Matter for IESBA Consideration**

3. Do IESBA members agree with the Task Force's conclusions to retain the intent test?

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<sup>2</sup> Paragraph R250.10 states that "A professional accountant shall not accept, or encourage others to accept, any inducement that the accountant has reason to believe is, or might be perceived by a reasonable and informed third party to be, made with the intention of improperly influencing the accountant."

<sup>3</sup> Paragraph R250.11 states that "A professional accountant shall not accept, or encourage others to accept, any inducement that the accountant has reason to believe is, or might be perceived by a reasonable and informed third party to be, made with the intention of improperly influencing the accountant."

<sup>4</sup> Extant paragraph 350.2 notes that "Offers of inducements may create threats to compliance with the fundamental principles. When a professional accountant in business or an immediate or close family member is offered an inducement, the situation shall be evaluated. Self-interest threats to objectivity or confidentiality are created when an inducement is made in an attempt to unduly influence actions or decisions, encourage illegal or dishonest behavior, or obtain confidential information. Intimidation threats to objectivity or confidentiality are created if such an inducement is accepted and it is followed by threats to make that offer public and damage the reputation of either the professional accountant in business or an immediate or close family member."

### **Factors to Determine the Intent of an Inducement Versus Factors to Evaluate the Level of Threats**

14. An IESBA member felt that it was confusing to repeat the same factors that a PA might use to consider whether there is an intent to improperly influence the recipient's behavior, to also evaluate the level of any threats created by offering or accepting inducements.
15. An approach similar to the one used in developing the requirements and application material in Sections 210 and 310 relating to the conflicts of interest sections of the proposed restructured Code could be used. A PA should first consider whether an inducement is being offered or received and then whether the offering or accepting would result in a threat to compliance with the fundamental principles. "Red flags" should be provided on how to assess the level of any threat to the fundamental principles.

#### *Task Force's Response*

16. The Task Force is of the view that while the factors referred to in paragraph 15 are the same, the initial decision to repeat them in the December 2016 draft was to clarify that they needed to be applied in two different circumstances – first in determining whether there is an intent to offer or accept an inducement, and then in evaluating the level of any threat that might be created by offering or accepting an inducement. In addition, the inclusion of "red flags" would not enhance the factors already listed.
17. Responsive to the IESBA member's concern, the application material in paragraph 250.14 A1 relating to evaluating the level of threats created by offering or accepting an inducement, has been revised to explain that the same factors used to determine the intent behind an inducement in paragraph 250.10 A1 can also be used for evaluating the level of any threat.
18. Consideration was also given to the reverse approach, where the factors would be listed in paragraph 250.14 A1 and referenced in the application material in 250.10 A1. However, it was decided that it was preferable to refer to guidance already previously covered, rather than to guidance later in the section.

#### **Matter for IESBA Consideration**

4. IESBA members are asked for views on the revisions made of the factors for evaluating the level of any threats with a reference paragraph.

### **Recusing from Business Related Decisions**

19. The Task Force is of the view that in the proposed Section 270<sup>5</sup>, the PA cannot simply recuse themselves from the individual or entity exerting the pressure, but has to consider whether recusal addresses the threat created by the pressure
20. To align with the related clarification in Section 270, application material has been added to the proposed Section 250 to clarify that in addition to removing themselves from any business related decisions, the PA has to consider whether the actions taken are appropriate to address the threat to compliance with the fundamental principles created by the inducement.

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<sup>5</sup> Proposed restructured Code Part 2, Section 270, *Pressure to Breach the Fundamental Principles*

### **Immediate or Close Family Members**

21. During its February 2017 meeting, the Task Force concluded that offering and accepting of inducements is not limited to situations in which the PA is directly involved. Inducements that might create an actual or perceived threat to the PA's ability to comply with the fundamental principles, might instead be offered to or received by, an immediate or close family member of the PA.

#### *Task Force's Response*

22. The Task Force believes that it necessary for the Code to provide guidance relating to these situations. For example, as a starting-point the PA has to be alert to the possibility that threats to the PA's compliance with the fundamental principles might arise if a family member is offering or receiving an inducement. The Task Force also believes that it is useful for the Code to explicitly state that when facing such situations the PA has to apply the same requirements and application material as when the PA is offering or receiving the inducement directly (i.e., comply with paragraphs R250.10–R250.16.)
23. In a situation where the PA is offering or being offered the inducement the relationship between the PA and counterparty only needs to be considered to evaluate any threats. However, where a family member is involved, the PA would also need to consider the relationships between the family member and:
- (a) The PA; and
  - (b) The counterparty offering or being offered the inducement
- as both of these can also impact the nature of the threat.
24. There might also be circumstances, for example where an immediate and close family member does not accept the PA's advice, where the PA concludes that the only way to address the threat is to not be involved in any business-related decisions involving the counterparty.

#### **Matter for IESBA Consideration**

5. IESBA members are asked for views on the revisions to the proposed guidance outlined above.

### **Proposed Conforming Amendments**

25. The Task Force is of the view that conforming amendments are needed to certain sections of the proposed restructured Code (for example, Sections 340,<sup>6</sup> 420<sup>7</sup> and 906<sup>8</sup>) in light of the revisions made in proposed Section 250.

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<sup>6</sup> Proposed restructured Code Part 3, Professional Accountants in Public Practice, Section 340, *Gifts and Hospitality* (Extant Part B, Section 260, *Gifts and Hospitality*)

<sup>7</sup> Proposed restructured Code Part 4A, Independence – Audits and Reviews, Section 420, *Gifts and Hospitality* (Extant Part B, Section 290, *Independence – Audits and Reviews*, paragraph 290.225)

<sup>8</sup> Proposed restructured Code Part 4B, Independence – *Other Assurance Engagements*, Section 906, *Gifts and Hospitality* (Extant Part B, Section 291, *Independence – Other Assurance Engagements*, paragraph 291.155)

*Section 340*

26. In considering necessary conforming changes to Section 340<sup>9</sup>, the Task Force has clarified that the counterparty offering or receiving the inducement can only be a client. The pronouncement has also been conformed to not only include the acceptance of, but also the offering of inducements. In addition, the examples have been tailored to be more appropriate to the relationship between a client and a professional accountant in public practice (PAPP).
27. The proposed conforming amendments in Section 340 would apply for the provisions of services that are not audits, reviews or other assurance engagements (e.g., in situations when a PAPP offers an inducement to, or receives an inducement from, for example a tax client).

*Sections 420 and 906*

28. The Task Force agreed to propose conforming amendments to Sections 420 and 906 of the International Independence Standards (i.e., Part 4A and 4B of the proposed restructured Code) to provide specific guidance for individuals performing audits, reviews and assurance engagements.
29. In its deliberations, the Task Force believed that directions in the proposed Section 340 should be considered in conjunction with Sections 420 and 906. However, when seeking guidance on accepting inducements from an audit or assurance client, a user of the Code might simply review the pronouncements in Section 420 and 906 and bypass Section 340. Also, the Code does not include any guidance on how Part 3 relates to Part 4-A and 4-B. It was thus felt that it would be beneficial to highlight the proposed requirements in Section 340 within Section 420 and 906.
30. Consideration was first given to the fact that the proposals should include directions for a user to consider the actual or perceived intent behind an inducement. In many instances the Independence Standards also include directions on how to address threats to compliance with the fundamental principles and independence as relates to an immediate or close family member. The Task Force is of the view that Sections 420 and 906 should also include a requirement regarding such a situation.
31. The addition of requirements relating to the intent of an inducement and immediate and close family members could be accomplished by repeating the relevant paragraphs from Section 340 in Sections 420 and 906. However this would result in a substantial increase in the length of these sections and be contrary to drafting guidelines, where reference paragraphs are preferred. Instead, requirements to review the relevant paragraphs of Section 340 relating to intent and immediate and close family members have been added.
32. Extant Sections 420 and 906 prohibit an inducement being accepted unless it is trivial and inconsequential in value. This diverges from the directions in Section 340, where an inducement that is not trivial and inconsequential can be accepted, provided that any threats have been eliminated or reduced to an acceptable level. The Task Force felt that such a divergence is in line with the extant pronouncements and hence should be maintained.
33. Consideration was also given to adding directions in Section 420 and 906 on offering an inducement. However it was concluded that since the extant pronouncements only consider the acceptance of trivial and inconsequential inducements, applying the same requirements to the offering of an inducement would constitute a substantive change. The Task Force is therefore proposing that if an

inducement is being offered to an audit or assurance client, directions in Section 340 should be considered.

**Matter for IESBA Consideration**

6. IESBA members are asked for views on the approach for developing proposed conforming amendments arising from the development of revisions to Section 250.