

Firm Culture and Governance

Summary of Outreach Meeting Discussion Notes by Stakeholder Groups

1. TORONTO – April 3rd and 4th Meeting with the Regulators:

- **Client and Firm Relationship**
 - **Early Considerations:** Discussions included identifying the client, partner remuneration and incentives, firm business models, and the predominance of consulting arms.
 - **Ethical Leadership:** It was noted that leadership significantly influences ethical behavior within firms, and the effect of leadership is not always aligned with the professional accountants (PAs) subject to the Code.
 - **Disclosures and Transparency:** There is a need for enhanced disclosures and transparency in audit and assurance reports, particularly concerning the independence of the processes followed.
- **Talent Attraction and Retention**
 - **Challenges in the Netherlands:** A participant highlighted difficulties in attracting and retaining talent in the Netherlands due to the reputation of firms and compliance issues.
 - **Big 4 in Canada:** It was noted that the Big 4 firms in Canada have an excess of staff, anticipating future assurance requirements. However, political factors in energy and resource-rich areas have resulted in a more conservative approach, affecting talent dynamics.
- **Culture and Governance**
 - **Regulatory Efforts:** Prudential regulators in the US, EU, and Canada have conducted work on firm culture and governance. Specifically, the Office of the Superintendent of Financial Institutions (OSFI) in Canada has engaged behavioral psychologists to review cultural aspects.
 - **CPAB Initiatives:** The Canadian Public Accountability Board (CPAB) has undertaken work on culture and governance related to quality and ISQM 1, including conducting culture surveys. CPAB's findings indicate governance variations and root causes of issues stemming from firm culture, revenue pressures, and a lack of transparency about identified issues.
 - **Global Firms and Culture:** Maintaining control over cultural issues becomes challenging as firms grow larger and more global. Establishing clear ownership of ethics within firms is crucial to addressing these challenges effectively.
- **Structural and Operational Issues**
 - **Short-term Focus:** The influence of private equity investment in firms was discussed, noting its impact on firm culture and independence. The short-term focus associated with private equity can lead to significant cultural and operational changes.
 - **Expert Structures:** It was highlighted that experts are often placed in separate structures within the firm. Agreements are established between the main firm and these separate

structures to provide specific services, which can affect the independence and integrity of these services.

- **OSC Staff Notice – Internal Ethics Policies and Procedures**

- The Ontario Securities Commission (OSC) provided this link: [OSC Staff Notice 52-724 Considerations for Public Accounting Firms in Developing Internal Ethics Policies and Procedures](#). Recent issues in Canada regarding false time records, cheating, and CPD violations were also discussed.

2. JAPAN - APRIL 16th – Meeting with the Firms

Representatives presented their firms' respective organizational charts and policies to support firm culture and governance, including notably.

- Management issues related to the governance of the firm as a whole,
- Ensuring commitments to audit the quality of the firm as a whole and
- Benefits and challenges of implementing Independent Non-Executives (INEs).

Meeting participants discussed the specific role, experience, and selection of INEs at their firms.

- **Corporate Governance Code:** Representatives discussed the corporate governance code, noting that while it mandates compensation for INEs, it does not provide specific rules regarding their independence.
- **Selection Criteria:** The selection of INEs typically considers their familiarity with the management team, knowledge of the corporate governance code, and expertise in the relevant industry.
- **Diversity:** While diversity is recognized as an important element in the selection process, it was noted that INEs are predominantly senior professionals nearing the end of their careers. However, there is a trend toward greater diversity.
- **Remuneration:** Non-partner remuneration, including that of INEs, is determined by market conditions.
- **Prerequisites for Selection:** It is essential for INEs to have a deep understanding of the market and the profession. This includes their role in contributing to the public interest and the Japanese economy.

3. SINGAPORE - APRIL 22nd to 25th Meetings with Regulators, Firms and Professional Accountancy Bodies

a) ASEAN regulators¹:

- There was general support for the IESBA workstream on firm culture and governance and recognition of its importance.
- Tone at the top is important, and it is important to see leaders walking the talk.
- Accountability at all levels of a firm is important, and key performance indicators (KPIs) must have more than just financial aspects.
- Based on some of their recent inspection findings, there were observations that ethical lapses in firms highlighting the importance of leadership and transparency as well as a lack of understanding of their public interest responsibility and the need for education; these ethical issues may arise from factors such as:
 - Changes in leadership and pressures to meet KPIs are often influenced by the tone set by top management.
 - Inadequate training programs that fail to keep professional accountants updated with the latest standards.
 - A culture or eagerness to serve the client as much as possible that does not align with the responsibility to serve the public interest led to the provision of prohibited non-assurance services by some firms.
 - Although a speak-up culture is encouraged, it is not widely practiced yet, possibly due to the prevailing norms within the local jurisdictions.
 - Ethical lapses often point to weaknesses in an organization's risk management framework. Emphasizing the need for robust risk assessment processes that can identify potential ethical pitfalls before they become issues could be beneficial.
 - Encouraging greater transparency within organizations can lead to better ethical practices. When actions and decisions are open to scrutiny, misconduct is less likely to occur.
- One regulator has ongoing one-on-one discussions with firm staff at different levels
- In the audit sector, strict regulations make ethical issues less of a concern. However, in some regions, there is a pressing need to build more capacity and capability within the profession, which can lead to lapses.
- Rapid regulatory landscape changes can lead to ethical challenges, especially in smaller firms, as larger firms have more robust monitoring processes in place. These changes can also affect staff retention and talent management, adding to these organizations' challenges. Firms are

¹ Accounting and Corporate Regulatory Authority (ACRA)(Singapore), Center for Supervision of the Financial Service Profession (PPPK)(Indonesia), Malaysia's Audit Oversight Board (AOB), Philippines's Securities and Exchange Commission (SEC) and Thailand's Securities and Exchange Commission (SEC).

increasing their education efforts on those parts of the firms that are not from the audit business line.

b) Firms:

- **General**

- Attitudes of culture change from market to market.
- When it comes to ethics, most staff want to do the right thing.

- **Values and Tone at the Top:**

- The commitment to trust is a fundamental part of every firm and its network, with leadership emphasizing the importance of ethical behavior.
- This commitment is communicated across all service lines through mission statements, core values, branding, and more.
- Key values such as Ethics, Integrity, Trust, and Independence are prioritized in the firm's agenda and are promoted through various internal platforms and programs.
- Some firms have engaged external consultants to strengthen this culture, moving away from the term "whistleblowing" to use "speak up," which is seen as less pejorative.

- **Governance, Monitoring, and Other Processes**

- Some firms have oversight committees instead of boards, and not all of them have independent non-executive members.
- One firm noted that its policies and rules are written in such a way as to safeguard its audit business.
- Robust structures and processes are established to monitor quality and ethical standards compliance.
- There are quality assurance and review functions through all business lines, and accountability is enforced through performance reviews.
- The International Standard on Quality Management (ISQM) is integrated within the firm's operational frameworks within the assurance practice.
- Measures such as quarterly and annual declarations, independent peer reviews, and regulatory audits are used to ensure compliance and address any non-compliance issues promptly.
- There is strong regulatory oversight in Singapore, and regulators have constant dialogue with the firms

- **Incentives:**

- Leadership and staff performance are evaluated against both qualitative and quantitative measures.

- Compliance with ethical policies is a critical criterion, and failure on this measure results in an overall negative performance evaluation and impact on rewards such as bonuses, regardless of other achievements.
- Partners are directly accountable for any non-compliance by their teams.
- **Consulting Business Line**
 - The firms are aware that while not of major concern, lateral hires need more training around understanding and compliance with ethical requirements.
- **Training:**
 - Training is a critical focus area, with strict penalties for non-compliance and deadlines not being met.
 - Continuous training is also important due to the annual turnover of staff.
 - Firms maintain a zero-tolerance policy towards cheating, with severe consequences for such violations.
- **Balancing Interests:**
 - Firms strive to maintain a balance between serving the interests of their clients and the public, ensuring that their actions benefit both stakeholders effectively.

Professional Accounting Bodies:

- **Adoption of ISQM**
 - The focus is on adopting the International Standard on Quality Management (ISQM), where the revised standards include provisions that address governance and culture. These standards are intended to be applied across the firm, not just within the audit division.
- **Leadership Influence**
 - The tone at the top is crucial. It's about how leadership attitudes and directives translate into meaningful changes in behavior and mindset throughout the organization.
- **Resource Constraints**
 - Some issues may arise from inadequate resources, like limited time on engagements, which might prevent thorough consideration of all aspects of an issue.

4. SAC BREAKOUT SESSIONS (APRIL 30th)

a) Group 1: Questions

1. What are your views on the themes/areas of inquiry highlighted in the presentation? Which of those themes/areas do you believe the WG should prioritize in its fact-finding and why? Are there additional themes/areas of inquiry you believe the WG should investigate?
2. Should the WG look broadly at organizational culture and corporate governance to determine what might be particularly relevant for firm culture and governance?
3. What do you believe would be key success factors for this workstream, and what might be risks or challenges to achieving them?
4. What are the key attributes of a governance framework within a firm that would contribute to the development of a strong ethical culture?

Public Interest vs. Business Interests

- Questions were raised about whether firms genuinely prioritize the public interest, with concerns that legal, contractual client relationships often overshadow broader public responsibilities.
- The term "public interest" is frequently used, but it is uncertain whether firms would identify it as their primary purpose.

Firm Leadership, Governance and Oversight

- Firm culture is shaped by leadership and the ethical framework established at the top, including the impact of remote work and long working hours on junior employees.
- Governance is important, and consideration should be given to matters such as board independence, diversity, determination of remuneration and appointment, and transparency.
- Accounting Europe (AE) initiated a project on firm governance involving a questionnaire focused on firms auditing the largest public interest entity (PIE) audit clients. The approach included understanding and analyzing consistency between issues or practices among firms and examining differences with the firm's transparency reports. The analysis also looked at those in management and executive roles, the profit-sharing functions of the firm, and what constitutes quality. The AE project also reviewed jurisdictional requirements, highlighting that jurisdictional differences often determine firm differences.
- The Islamic Financial Services Board's (ISFB) work on firm culture is guided by Harvard Business School's eight pillars of ethical culture. It focuses on awareness and compliance from junior employees to leadership. The proposals were exposed to public consultation, emphasizing transparency.
- ISFB conducted a gap analysis of culture versus governance to identify discrepancies, suggesting the need for a more comprehensive analysis in the future.
- Establishing oversight committees consisting of non-professional accountants was suggested to enhance firm governance. In Greece, creating an oversight committee with non-PAs to oversee firm governance is considered.

- Increasingly, the firms' managing partners are not from the audit business line but from the consulting arm who could be more focused on profits.
- A query was raised on who plays the role of investors in the context of audit work and whether the regulator played such a role.
- The increasing investment of private equity (PE) funds into firms could become problematic in the future. There is a concern that such PE funds may also be firm clients.
- Whistleblowing is an important element of firm culture and governance. Effective whistleblowing helps stakeholders understand the issues (not just the fines given to firms). However, it was observed that even if a whistleblowing system is comprehensive on paper, it does not necessarily mean that it is effective and often causes corporate failures.
- The IESBA's work should avoid overlapping with ISQM1's requirements on firm governance.

Audit and Consultancy Conflicts

- The coexistence of consulting and audit arms within the same firm was criticized, noting that this could skew incentives toward revenue generation over audit quality.
- Concerns about conflicts of interest were highlighted, suggesting that firm revenues and audit quality are not necessarily linked.
- Audit fees have a strong correlation with audit quality across all jurisdictions.

Regulatory Measures

- Calls were made for stricter punishments for fraud and greater collaboration with government and regulators to enforce ethical standards.

Cultural Challenges and Behavioral Insights

- The difficulty of addressing cultural issues was discussed, as they are deeply rooted in behavior and practices within firms, such as exam fraud and employee pressure.
- The IESBA workstream on firm culture is a more challenging topic than firm governance, as culture is about behavior. Due to its complex nature, there was a suggestion that the IESBA workstream might benefit from a narrower focus on governance rather than culture. In response to this suggestion, there was also an opposing view that governance is the ability of a board to take action. In contrast, the Code is a mechanism that helps address cultural issues rather than governance.

Scope and Definition of Client

- The definition of "the client" in audit engagements was discussed, including that it should ideally be the investors and users, but the true client is likely to be perceived as management as the one "paying the bill."

b) Group 2: Questions

1. What are your views on the themes/areas of inquiry highlighted in the presentation? Which of those themes/areas do you believe the WG should prioritize in its fact-finding and why? Are there additional themes/areas of inquiry you believe the WG should investigate?
2. Do you think there is an expectation gap about the effectiveness of an accounting firm's governance framework in addressing unethical behavior or weaknesses/shortcomings in ethical culture in a timely manner? If so, what might be contributing to this gap?
3. Do you believe the IESBA's work risks creating confusion about the roles of various market participants on this topic (e.g., legislators, regulators, and firms)? If so, what advice would you give the IESBA on the appropriate guardrails as it charts a path forward on this strategic initiative?

Firm Governance and Leadership

- The critical role of governance structures and leadership in firms was highlighted. It was noted that weak leadership leads to weak firm governance. Strong, transparent leadership is essential to ensure firm accountability and ethical behavior.
- Recent exam cheating scandals indicated broader cultural issues within firms. This highlights the need for better compliance training and a deeper focus on cultivating an ethical culture.

Transparency and Disclosure

- Differences in disclosure requirements across jurisdictions were discussed, with particular attention to the lack of formal governance disclosure in Brazil and its impact on firm behavior.
- Concerns about the transparency of incentive structures and their influence on behavior were raised. More transparent and accessible reporting was suggested as a means to improve governance. As an example, governance structures and transparency reports in Japan significantly influence auditor appointments and firm behavior.

Incentives and Behavior

- Incentives were identified as a major factor in driving firm behavior. The structure of incentives significantly affects governance and ethical practices.
- Breaking the incentive link between audit firms and their clients was advocated to better align with shareholder interests, potentially enhancing accountability and ethical practices.

Private Equity and Investment Impact

- The growing role of private equity in the profession was discussed, raising questions about its influence on firm behavior and potential conflicts of interest, which may lead to systemic issues.

Regulatory Measures

- The role of regulators and market discipline in shaping firm behavior was discussed. It was suggested that better regulatory frameworks and increased shareholder involvement could enforce higher standards of accountability and transparency.

Scope and Application of the Code

- The importance of adopting and enforcing a global ethical code to raise ethical and independence standards across jurisdictions was emphasized. The challenges of achieving worldwide adoption of these codes were also noted.

c) Group 3: Questions

1. What are your views on the themes/areas of inquiry highlighted in the presentation? Which of those themes/areas do you believe the WG should prioritize in its fact-finding and why? Are there additional themes/areas of inquiry you believe the WG should investigate?
2. What are your views on the tension between an accounting firm's responsibility to act in the public interest and its profit-making goal as a private business? How do you think firms can best address that tension?

Governance and Leadership

- Firms compromise to meet client expectations, engaging in unethical practices such as adjusting audit team sizes or cheating on exams. Whilst these issues are not necessarily systemic, they are worrisome, particularly if PAs experience them during their formative years in the firms.
- Maximizing profit is a driving force in for-profit businesses. Ethical standards alone cannot address this matter.
- Firm leadership and culture are crucial, established through mechanisms like tone at the top.
- The tone at the top is crucial, but partner/rotation relationships may hinder its effectiveness as leadership changes can change the firm's ethical tone. Maintaining consistent governance practices will help to address this concern.

Transparency and Accountability

- Increased transparency in firms' operations is necessary to enable regulators and the public to assess firms' adherence to ethical standards.
- Aligning incentives with performance management, which includes appropriate non-financial indicators, and implementing a quality management (QM) system with checks and balances were suggested.
- There is a tension between firms' profit-making goals and their responsibility to act in the public interest. Enhanced regulatory oversight could help align firm actions with public trust.
- It is important to also gain an understanding of the culture and governance in small and medium practices (SMPs)
- If public trust is compromised due to unethical behavior, this could result in significant financial damage to the firm or, in the worst-case scenario, its demise. The example of Arthur Anderson was cited to support this point.

Scope and Application of the Code

- There was a concern the IESBA Code only affects the audit business line of the firm, with a suggestion that IESBA should ensure comprehensive ethical coverage across all services provided by accounting firms.
- Ethical issues also happen in professional service firms other than accounting firms, particularly if they are not subject to regulatory oversight.
- Whilst IESBA may raise awareness of certain issues, it may not have the means to take further action as some issues are local-specific (e.g., market structure).
- Regulatory oversight is an important part of the solution. Penalties could be served as an important deterrent.

Education and Culture Formation

- A holistic approach to culture was proposed, emphasizing the need to instill the right values from the early stages of education and throughout professional development. The right culture would help ensure that the right leaders, capable of maintaining an ethical culture, are elected.

5. NATIONAL STANDARD SETTERS (MAY 2nd)

- **Importance of Firm Culture and Governance**

Addressing firm culture and governance is crucial to mitigate persistent problems despite the presence of strong codes and performance frameworks. This strategic focus aims to understand why issues persist despite existing standards and to identify incentives for unethical behavior or lack of incentives for ethical behavior within firms. Emphasizing these aspects is vital for ensuring ethical behavior and improving audit quality.

- **Understanding and Identifying Issues**

A clear understanding of the issues is necessary before identifying solutions. It is important to articulate what specific problems need to be addressed and how potential solutions can effectively change behavior. Avoiding an expectation gap is crucial; changing standards without corresponding behavioral changes can lead to unmet expectations. Early involvement of the IAASB in the project is essential to address quality management issues and ensure alignment with existing standards.

Gathering stakeholder feedback and conducting outreach activities are crucial for understanding the factors that create environments for ethical lapses. This information is essential for formulating effective strategies and recommendations. The feedback indicates that while the code provides a strong foundation, its application in non-audit services and understanding its principles vary. Engaging with various stakeholders, including firms, regulators, and users, helps gather diverse perspectives and identify common issues.

- **Code Compliance and Training**

There is a need to question whether specific changes to the Code are required or if enforcing existing principles suffices. The code's principles-based approach provides a strong foundation. Still, there may be gaps in how these principles are understood and applied across different parts of firms, especially in non-audit services. Non-authoritative guidance and training for firms can enhance understanding and compliance with the code. Effective enforcement and disciplinary actions are necessary to maintain ethical behavior, and firms should have mechanisms to ensure that breaches are addressed adequately.

Compliance officers play a significant role in ensuring ethical behavior within firms. Their reporting structures should ensure independence and effectiveness. Training and regular reinforcement of ethical standards are also crucial for maintaining a culture of integrity. Firms must ensure that all staff, including those in non-audit services, understand their ethical obligations. Regular training and clear communication about ethical standards can help foster an ethical culture.

- **Regulatory and Enforcement Challenges**

To address fundamental conduct-related issues within firms, more than quality management may be needed. While quality management standards are important, they often focus on audit quality and may not encompass broader ethical and governance issues. Early engagement with regulators can help understand regulatory capabilities and limitations, ensuring that the proposed solutions are practical and enforceable. Audit firm governance codes will have different impacts and reach compared to ISQM 1 in areas such as organizational and governance structures and transparency requirements.

- **Tension between Public Interest and Revenue**

Balancing revenue growth with acting in the public interest is essential. Profit is necessary to finance future obligations and maintain ethical standards, but it should not compromise firms' integrity and ethical behavior. There is a tension between being profit-driven and upholding public interest, and this needs careful management. Distinguishing between cultural issues and individual misconduct is important for accurate problem identification and for implementing appropriate solutions.

- **Local Definition of “Firm”**

Defining what constitutes a firm and regulating a network of firms pose some challenges. The complexity arises from the varied legal structures within firms, such as partnerships and corporate entities. Implementing broad regulatory ambitions at the national level can be complex, and it is crucial to ensure that regulations encompass the entire firm, including non-audit services. Understanding the jurisdictional enforcement nuances is essential for effective regulation.

- **Australian Senate Inquiries**

Federal senate inquiries ([Inquiry into management and assurance of integrity by consulting services](#) and [Ethics and Professional Accountability: Structural Challenges in the Audit, Assurance, and Consultancy Industry](#)) in Australia have highlighted several issues, such as partnership structure, conflict of interest, public interest obligations, and compliance with the code. The inquiries revealed that partnership structures can limit transparency and accountability. Conflicts of interest, especially when firms provide consulting services to government departments, need careful management. Profit motives sometimes overshadow the obligation to act in the public interest. Robust codes and whistleblowing protections are needed, and effective monitoring and enforcement mechanisms are essential to ensure compliance.

6. **AUSTRALIAN OUTREACH (MAY)**

a) **Regulators:**

• **Leadership and Accountability**

- There is a need to understand the relationship more clearly between global leadership and local networks within large firms.
- There were discussions on how global leadership can be held accountable for failures within the network. There should also be mechanisms to make local managing partners accountable to the global leadership. Without clear accountability at the leadership level, enforcing cultural changes within the firms is challenging.
- Establishing clear accountability is crucial for driving and enforcing cultural change within the organizations.
- Acknowledgment that big firms with a large number of people necessitate a different approach to leadership and management compared to small “boutique” firms.
- For the Big Four firms, global teams typically conduct quality reviews of selected files from the networks. It was suggested that the International Ethics Standards Board for Accountants (IESBA) should inquire about what firms are doing locally regarding these reviews.

• **Enforcement and Monitoring**

- It was noted that the Australian Commonwealth does not have the constitutional power to regulate partnerships directly.
- Traditionally, monitoring and enforcement have been carried out by ASIC and through the profession’s self-regulation. It was pointed out ASIC only possesses partial regulatory tools, highlighting limitations in its enforcement capabilities.
- Concerns were raised about market concentration, particularly if one of the Big 4 firms is barred from providing audit services. There is a risk that other firms may not have the capacity to meet the additional demand, creating potential market disruptions.
- In 2023, the Australian Financial Reporting Council (FRC) reviewed the effectiveness of self-regulation by Professional Accountancy Organizations (PAOs). This review considered the effectiveness of self-regulation by the PAOs and the role of the local audit regulator, the Australian Securities and Investments Commission (ASIC), including its primary focus on the Big 4 firms. The Australian Treasury has released two consultation papers in response to the PwC tax scandal on May 5:
 - [Response to PwC – tax regulator information gathering powers review](#)
 - [Response to PwC – regulation of accounting, auditing, and consulting firms in Australia](#)

• **Rewards and Recognition**

- It was noted that rewards and recognition play a significant role in driving behavior within firms.

- **Scope IESBA's FCG Initiative**

- There was a query about whether inclusivity and diversity are included in the new IESBA work stream.

b) Firms:

- **Role of IESBA in Ethical Culture:**

- The topic of ethical culture is timely and relevant.
- Instead of introducing new standards, IESBA should explore ways for firms to embrace and foster an ethical culture within their existing frameworks.
- Firms know the importance of ethical practices and have measures in place to mitigate risks.

- **Differences Between Consulting and Audit:**

- Ethical considerations are more deeply embedded in the audit profession than consulting.
- Consultants often come from various professional backgrounds, which can lead to less uniformity in ethical standards.
- Many partners in technology and sustainability are not PAs.

- **Firm Size**

- Larger firms do not inherently have poorer cultures compared to smaller firms. Smaller firms might struggle with changing their culture due to limited resources and tools.

- **Concerns About Audit as a Loss Leader:**

- There are concerns regarding the perception of audit services being treated as loss leaders within firms. This could impact the emphasis on quality and ethical standards in audit practices.

c) National Standard Setters:

- **Enforcement and Monitoring**

- Effective regulations are needed to change people's mindsets. Education is also important, as all players need to give the same messages to reinforce the desired mindset.
- The dividing line between the role of IESBA and regulators is important to understand
- Limited Liability by Partnership: In Australia, the limit for limited liability by partnership is relatively low, which may be an issue.
- De-registering Large Firms: De-registering large firms in Australia for non-compliance is challenging due to a lack of market diversity.

- **Firm Structure and Leadership**

- There is a concern about whether firms retain the right people to reach the top of the pyramid staff structure.

- Strong Leadership: Strong leadership is essential to support the right firm culture.