

Firm Culture and Governance (FCG) Issues Paper

This paper includes a discussion of key stakeholder feedback from the FCG Dialogues (compiled in **Agenda Item 2**) and potential options for the way forward regarding the location and related authority of an FCG framework.

This paper is organized as follows:

- I. Objectives of an FCG Framework
- II. Key Themes Heard during the FCG Dialogues
- III. Suggested Approaches for an FCG Framework Heard during the FCG Dialogues
- IV. Options for the Way Forward Regarding an FCG Framework – Location and Related Authority
- V. Project Team's (PT's) Recommendation for the Way Forward

Appendix 1: Examples of Regulatory Findings where FCG is Highlighted

Appendix 2: For Reference Only – Illustration of Option 2

Appendix 3: For Reference Only – Illustration of Option 3

I. Objectives of an FCG Framework

1. The IESBA took on FCG as a strategic priority when developing its 2024-2027 Strategy and Work Plan following recurrent high-profile cases of unethical behavior in accounting firms in multiple jurisdictions that resulted in damaging consequences for individual professional accountants (PAs) as well as their firms and other personnel. The IESBA's FCG Working Group undertook extensive information gathering over the course of 2024, culminating in the Working Group's conclusions and recommendations as embodied in its [final report](#) to the IESBA.¹
2. On the basis of the final report's recommendations, in December 2024, the IESBA approved a [project proposal](#) to develop a principles-based FCG framework that promotes, supports and reinforces a high standard of ethical behavior by a firm's leadership, other partners and staff across all of the firm's services.
3. In practical terms, the FCG framework is intended to serve a number of key objectives:
 - To provide a common understanding of the key factors that underpin a strong ethical culture in firms (i.e., the eight FCG elements identified in the Working Group's final report).

¹ The Working Group's charge included, among other matters, gathering an understanding of culture and governance and their impact on compliance with ethical requirements in accounting firms and, where applicable, their networks, and developing recommendations to the IESBA. The development of the report was informed by extensive outreach to stakeholders, including regulators and oversight bodies, investors and the corporate governance community, accounting firms, professional accountancy organizations, jurisdictional standard setters and the Stakeholder Advisory Council, as well as the commissioning of an academic report summarizing a review of global academic literature on the topic of organizational culture. The Working Group's final report was published in January 2025.

- To promote or motivate positive changes in mindset, behaviors and practices within firms that support an ethical culture.
 - To enhance consistency and comparability across firms by providing a global baseline against which firms can assess their FCG practices across all their service lines.
 - To enable firms to mitigate the risks of unethical behavior and strengthen public trust and confidence across all of their service lines.
 - To support and encourage ongoing dialogue on FCG within firms and among stakeholders.
4. The FCG framework is not intended to be a compliance checklist or documentation tool, but a generally accepted means through which firms can reflect on their internal practices supporting an ethical culture and take appropriate action where necessary.

II. Key Themes Heard during the FCG Dialogues

5. From January to May 2026, the PT undertook a series of FCG dialogues with targeted stakeholders to discuss questions focused on the content, location and related authority of an FCG framework as set out in the [Briefing Note](#) for the FCG focus group meetings. As explained in the Briefing Note, the IESBA viewpoints developed for purposes of the dialogues illustrate the key characteristics identified by the Board that underpin the eight elements of the FCG framework. See details of the FCG dialogues held² and the key takeaways in the Appendix to **Agenda Item 2**.
6. Below are the key themes that came through from the dialogues, and the PT's responses.

Recognition of the Importance of FCG but Different Views on How Best to Approach the Development of the Framework

7. There was broad recognition that having an ethical culture is essential to firms, with views that it supports high-quality services, promotes the attractiveness of the profession, protects firms' brand name, and enhances public trust in firms. There was also recognition of ethical leadership as a foundational element of FCG, and that a lack of the right tone at the top is a significant contributing factor to ethical failures at firms.
8. However, there were different views as to whether the IESBA should develop a new standard to address the topic of FCG. Some stakeholders with whom the PT engaged (mostly investors and other user representatives and some regulatory representatives) supported having mandatory high-level principles in the Code. For some regulators in particular, enforceability of the provisions was an important consideration. However, a number of other stakeholders (mostly firm representatives and some regulatory representatives) preferred the development of non-authoritative material (NAM). These other stakeholders saw a framework in the Code as potentially driving a compliance approach to FCG, with concerns about significant implementation costs and burdensome documentation on top of the costs of implementing ISQM 1.³ By contrast, these other stakeholders felt that NAM would

² The FCG dialogues were held with, among others, representatives of the Global Public Policy Committee (GPPC), representatives of the IFAC Small-medium Practitioners Advisory Group (SMP AG), regulatory and oversight body representatives, and the IAASB-IESBA User Advisory Group.

³ ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

provide much more flexibility and timeliness and have a greater impact on promoting the desired FCG practices.

9. In this regard, across all the stakeholder groups, there was broad support for the development of practical NAM to support education and training on FCG, with some considering that such NAM could well complement high-level provisions on FCG in the Code. There was in particular support for scenario-based guidance and practice examples that show what ‘good’ looks like.
10. Beyond the question of whether to develop a standard or NAM, there were also a number of options suggested by dialogue participants regarding how the IESBA could approach the development of an FCG framework. These are discussed in Section III below.

PT Response

11. The PT acknowledges the different views expressed with respect to the location and related authority of an FCG framework. The PT has considered those views, their underlying rationale, and the public interest in recommending a way forward. (See Section V.)
12. The PT also notes the strong support for the development of NAM,⁴ and has considered that support in recommending a way forward. (See Section V.)

Root Cause Analysis

13. There were questions about why the FCG project was launched and whether a root cause analysis of ethical failures at firms had been undertaken as a basis for the project.

PT Response

14. The FCG project was initiated as a result of the IESBA identifying FCG as a “burning platform” issue in its 2024-2027 Strategy and Work Plan. This was in response to persistent high-profile cases of unethical behavior in accounting firms and their damaging consequences for the personnel and firms involved, collateral consequences for other firm personnel as well as clients, and adverse impacts on the reputation of, and public trust in, the firms and the profession.
15. In response to the question as to whether a root cause analysis had been performed, the PT notes the following:
 - The Working Group’s philosophy during the information-gathering phase in 2024 was to approach this project *positively* and determine whether, if a specific FCG element was present, it would have addressed the ethical failure. The eight elements that drive an ethical culture in a firm were distilled from the analysis of the extensive information gathered. So, in essence,

4 Under its Terms of Reference, the IESBA may publish NAM to advance public understanding of its standards. There are different types of NAM including:

- Staff publications such as Bases for Conclusions, Staff Questions & Answers, Staff Alerts, and technical overviews.
- Scenario-based guidance on applying the Code on specific topics or in specific areas.
- Thought leadership publications.

While the IESBA is not required under its Terms of Reference to follow due process in developing NAM, it applies a level of rigor in developing NAM, including review and oversight by senior staff, consultation with practitioners and experts depending on the nature and complexity of the NAM, and targeted Board review.

the Working Group had already undertaken a root cause analysis, but from a different approach.

- In developing its report, the Working Group was especially sensitive to avoiding singling out any particular firms by analyzing past cases of ethical failures, and any details of past incidents were kept at a high level in the report. Nevertheless, as a response to the calls for a root cause analysis, the PT has set out in **Appendix 1** some examples of regulatory findings involving accounting firms where one or more of the eight FCG elements have been noted as reasons for enabling the ethical failures reported.
- Across all stakeholder groups with whom the PT has engaged, there has been clear acknowledgment of the importance of an ethical culture in firms. Indeed, various stakeholders, including those from firms, have emphasized the importance of a number of the elements of the FCG framework, such as ethical leadership, oversight and governance, incentives, independent input, and education and training.
- In the various FCG dialogues, representatives of large firms and small and medium practices (SMPs) have strongly advocated for the development of practical NAM, believing that the avenue of education and training (i.e., one of the FCG elements) would have the greatest impact in strengthening ethical culture and, ultimately, compliance with the Code. Several have suggested the value of such NAM in showing what “good” looks like when it comes to the FCG elements, including ethical leadership. In this regard, some representatives from large firms have indicated that they would welcome the opportunity for their firms to collaborate with the IESBA by sharing good FCG practices the firms have implemented.
- The importance of ethical culture in promoting ethical behavior is settled debate. The [academic report](#) the IESBA commissioned to summarize global academic literature on the topic of organizational culture concluded that individual behavior does not occur in a vacuum. It found that individual unethical conduct is typically enabled or exacerbated by the surrounding collective and organizational culture.⁵ In that context, the project’s goal is to identify and articulate the essential elements of an ethical culture in a clear, simple and coherent framework. This is because it is in the public interest to establish a common basis that all stakeholders can understand so that any discussion about ethical culture within firms and among stakeholders can be held on clear and consistent terms: What precisely is the focus of the inquiry or reflection? What does it take to make an ethical culture happen? Where are the nuances, challenges and complexities?

⁵ “Most people are the product of the context they find themselves in. They tend to ‘look up and look around’, and they do what others around them do or expect them to do” (Trevino & Brown, 2004, p. 72), or as more forcefully put by Philip Zimbardo (2005) “you can’t be a sweet cucumber in a vinegar barrel”. Schein (2010, p. 193) observes “...when we see the essence of a culture — the paradigm by which people operate — we are struck by how powerful our insight into that organization now is, and we can see instantly why certain things work the way they do, why certain proposals are never bought, why change is so difficult, why certain people leave, and so on. It is the search for and the occasional finding of this central insight that makes it all worthwhile. Suddenly we understand an organization; suddenly we see what makes it tick”. **Organizational misconduct**, unlike misconduct against the organization, **generally involves many people. Individuals acting together “can produce morally objectionable events and states of affairs that no individual acting alone could produce”** (McMahon, 1995, p. 550). As Sharp-Paine (1994) explains “**rarely do the character flaws of a lone actor fully explain corporate misconduct. More typically, unethical business practice involves the tacit, if not explicit, cooperation of others, and reflects the values, attitudes, beliefs, language, and behavioral patterns that define an organization’s operating culture**” (p. 106).

16. So, the PT believes that undertaking any further root cause analysis as a basis for developing an FCG framework would serve minimal benefit given the extensive work already done in this project over the past 2.5 years and the generally strong support across the stakeholder community for the objectives of the project. The PT, however, recognizes that there are differences of views among stakeholders as to how best to approach the development of the framework.

Whether There is a Need for an FCG Framework

17. There were some views that the Code's fundamental principles are adequate since there were clear breaches of the Code in all instances of ethical failures. It was argued that if individuals had indeed complied with the Code, the ethical failures would not have occurred. There were suggestions that instead of developing a framework, the IESBA should assist with the effective implementation and application of the Code. The potential impact of education and training materials in helping to achieve such an outcome was especially emphasized. There were also a few views that the lack of robust enforcement of the Code in some jurisdictions, especially when regulatory or oversight bodies are under-resourced, could be a contributing factor to low compliance with the Code.

PT Response

18. The PT recognizes that while there is a clear relationship between the five fundamental principles in the Code and recent ethical failures,⁶ individual behavior as well as judgments in applying the conceptual framework and complying with the Code are strongly influenced by organizational culture.
19. As noted above, academic literature finds that culture is closely linked to group behavior and that group contexts shape and influence individual behavior.⁷ This means that if the overall collective behavior (i.e., culture) in a firm does not champion ethics and compliance with the Code's fundamental principles, then even if one person might individually make the right choices and comply with the Code, they might behave differently in the group context.
20. The extant Code recognizes that organizational culture is essential to an individual PA's consideration of the threats to compliance with the fundamental principles (see paragraphs 120.13 A1 to A3). However, the Code currently does not address ethical culture in a holistic, comprehensive manner. Specifically, when compared to the eight FCG elements, the PT observes that:
- Ethical leadership is only broadly mentioned in paragraphs 120.13 A2(a) and A3(a).
 - Oversight and governance is mentioned in paragraph 120.13 A2 but only in passing ("management processes" in bullet (b)) or in connection with speak-up mechanisms (in bullet (c)).
 - Neither independent input nor transparency is mentioned.
 - Accountability across the firm is only generally mentioned in paragraph 120.13 A2(a).
 - Incentives and disincentives is only broadly mentioned in paragraph 120.13 A2(b).

⁶ For example, exam cheating scandals speak to a breach of the fundamental principles of integrity and professional behavior.

⁷ See the [academic report](#) commissioned by the IESBA, in particular page 1 ("*Regulators are increasingly focusing on culture to prevent organizational misconduct, appreciating that in many cases of such misconduct, the cause is not unethical people but often unethical cultures, leadership and systems.*"). See also footnote 6.

- Open discussion and challenge is mentioned in paragraph 120.13 A2(c) but only the aspect of speaking up.
 - Education and training is only broadly mentioned in paragraph 120.13 A2(b).
21. See also **Agenda Item 2B** where the third column includes a gap analysis vis-à-vis the extant Code and the viewpoints deemed by the PT and the Board Advisors as potential enduring principles of an FCG framework.
22. The PT also notes that the extant Code's provisions on organizational culture are not sufficiently focused on what a firm can do to promote an ethical culture to support an individual's compliance with the fundamental principles.

Given these gaps, the PT believes there is scope to enhance and refine the Code's focus on FCG and that this would help firms to reduce or mitigate the occurrence of further ethical failures. Nevertheless, this does not mean that an FCG framework will prevent all ethical failures in the future. However, to the extent an FCG framework can help reduce or mitigate the likelihood of unethical behavior, this would achieve one of its key objectives.

ISQM 1 Addresses the Substance of an FCG Framework

23. There was a view that ISQM 1 sufficiently addresses the substance of an FCG framework. There were also a few suggestions that if there are any "gaps" between the substance of an FCG framework and ISQM 1, they could be addressed through non-authoritative guidance on implementing ISQM 1 or amendments to ISQM 1.

PT Response

24. The PT notes that while quality management and culture are related in that they are mutually supportive, they are not the same. A strong ethical culture helps to mitigate unethical behavior, strengthens governance, and builds resilience. Quality management helps to deliver high quality services. Both have their own place and neither substitutes for the other. Specifically:
- ISQM 1 requires firms that perform engagements within the scope of the IAASB's engagement standards to design, implement and operate a system of quality management to provide firms with reasonable assurance that the objectives of the system of quality management are achieved, thereby enabling the consistent performance of quality engagements and issuance of appropriate reports. It requires that the firm demonstrates a commitment to quality through a culture that exists throughout the firm, which recognizes and reinforces, among others, the importance of professional ethics, values, and attitudes.
 - An FCG framework focuses on *how* firms can develop a strong ethical culture by embedding ethical values within the whole firm through eight elements of firm culture and governance.
25. Therefore, the objectives of ISQM 1 and an FCG framework are different despite there being linkages and mutually supportive aspects. Importantly, the FCG project's scope addresses all accounting firms, many of which perform services that are not within the scope of the IAASB's engagement standards and thus do not have to comply with ISQM 1.
26. For these reasons, the PT does not believe that FCG can be addressed through amendments or non-authoritative guidance to ISQM 1. This was also acknowledged by other participants in the FCG

dialogues, although there was a recognition that the FCG framework and ISQM 1 should complement each other, especially for firms that have implemented ISQM 1.

27. The PT has developed a [linkages paper](#) in close coordination with IAASB representatives. The paper explains at a high level the linkages and key differences between ISQM 1 and the viewpoints. It highlights that while there are mutually supportive aspects of the viewpoints and ISQM 1, there are significant differences in their objectives, scope, output and specificity of focus.
28. The PT plans to provide an updated analysis of the linkages to ISQM 1 in due course (and in coordination with the IAASB), based on the approach the IESBA determines to pursue regarding the development of the framework at its June 2026 meeting. The updated linkages document would assist firms in making qualitative assessments of the linkages and distinctions between the framework and ISQM 1.
29. The PT also notes that some firms, through establishing quality management objectives related to an ethical culture, may have already implemented one or more of the eight FCG elements underpinning an FCG framework.

Cost-Benefit Analysis for an FCG Framework

30. There were views that an FCG framework would (i) be unduly costly to implement compared to its benefits, and (ii) become a compliance exercise leading to extensive documentation. Accordingly, there were a few calls for a cost-benefit analysis before moving forward with developing the framework.

PT Response

31. Regarding the views on the costs and benefits of an FCG framework, the PT notes that the costs of implementing an FCG framework will vary depending on individual firm circumstances, including among others:

- Whether a firm has previously taken steps to develop or strengthen its ethical culture.
- Whether a firm has implemented ISQM 1, and if so, the actions it has taken to implement ISQM 1, including the scope and specificity with which it set quality objectives, identified and assessed quality risks, and implemented quality responses.

Regardless of the extent to which a firm might have implemented the FCG elements, the FCG framework is intended by design to be scalable and proportionate, aligning with the characteristics of the [Public Interest Framework](#).

32. While the benefits of ethical behavior are impossible to quantify in monetary terms, it is clear that failure to foster an ethical culture and establish appropriate governance mechanisms to mitigate unethical behavior can lead to substantial harm to:

- The particular firm in terms of potential regulatory sanctions, financial penalties and damage to its business and reputation.
- Its people in terms of morale, motivation to continue pursuing their careers with the firm, and potential job losses.
- A client or clients in terms of unintended adverse consequences to them and their shareholders.

- Public trust and confidence in the firm as well as the broader accountancy profession.
33. Regarding concerns that an FCG framework could create additional documentation burdens, the PT acknowledges that these views stem from firms' perspectives that they may need to:
- Demonstrate to regulators or oversight bodies that the framework has been appropriately implemented and is operating effectively; and
 - Mitigate potential litigation or regulatory risks in circumstances where a firm determines that a particular FCG element or characteristic of the element is not necessary or applicable, including by documenting the rationale for that determination.
34. The PT notes that the Code generally encourages but does not require documentation except in specific circumstances. The aim of the FCG framework is anything but to create compliance checklists or a documentation tool, which would detract from the key objectives of the framework set out in paragraph 3 above.

Target Audience for an FCG Framework

35. There was a view that the ethical failures seen in the news headlines are generally associated with larger firms rather than smaller practices. In addition, there was a view that SMPs may more easily address culture and governance issues than larger firms given their smaller size and closer ownership structures. As a result, SMPs should be excluded from the applicability of the FCG framework. (See discussion of the threshold approach in Section III.)

PT Response

36. The PT notes that the FCG project aims to address ethical culture in all firms and across all service lines with the objective of minimizing the risk of ethical failures and maintaining public trust in firms and the profession. Ethical failures may occur in firms of all sizes and any service line. Therefore, adding a threshold for the applicability of the FCG framework to scope out certain types of firms on a global level could detract from the objectives of the project.
37. All PAs need to comply with the five fundamental principles and apply the conceptual framework, as one cannot have 'less integrity' versus another depending on a threshold. Similarly, for there to be a common baseline for ethical culture to strengthen public trust and confidence in the profession, the FCG framework should be applicable across all firms. Nevertheless, there may be aspects of certain FCG elements such as independent input and transparency that may lend themselves to considerations of applying a threshold. (See further discussion of the threshold approach in Section III.)

Lack of Oversight Powers for All Services Across a Firm

38. There were doubts about the enforceability⁸ of an FCG framework that applies to all service lines of a firm since audit regulators generally only have supervisory and oversight powers over audit and, in some jurisdictions, certain assurance engagements.

⁸ Enforceability is one of the qualitative characteristics that the standards issued by IESBA should exhibit as set out in the [Public Interest Framework](#) (PIF).

PT Response

39. The PT notes that enforceability as a characteristic in the Public Interest Framework relates to the need for the framework to be designed in a way that “clearly states responsibilities that make it possible to ascertain the extent to which an auditor or PA has complied with the standard.” In doing so, it facilitates enforcement by the appropriate authority.
40. The existence of such authority is dependent on individual jurisdictions, some of which may need to allocate the relevant powers to existing or new local bodies.
41. In addition, there are other regulators or local bodies beyond audit regulators that might be entrusted with the oversight of a firm’s other service lines (e.g., tax authorities).

III. Suggested Approaches for an FCG Framework Heard During the FCG Dialogues

42. Participants in the FCG dialogues also suggested several approaches for the way forward in relation to an FCG framework:
 - Hybrid approach, consisting of high-level provisions in the Code complemented by non-authoritative guidance.

The rationale for this approach is to set out an enforceable baseline expectation in the Code, allowing for the development of practical guidance to support implementation of the specific provisions in the Code.

PT Response

The PT notes that this approach would achieve the objectives of an FCG framework by providing a global baseline against which firms can consistently assess their FCG practices, as well as facilitating a common understanding of the key factors that underpin a strong ethical culture in firms.

- Phased approach, consisting of guidance for an FCG framework outside the Code for voluntary adoption first, with any subsequent codification of key principles informed by experience gained through application of such guidance.

The rationale for this approach is two-fold. The first is to provide time for firms to voluntarily apply the guidance to their circumstances, and through the experience of using the guidance in practice, help inform the IESBA’s consideration of which aspects of the guidance might be key principles to incorporate into the Code. The second is to minimize the perceived compliance costs that a mandatory FCG framework might bring.

PT Response

The PT notes that the first phase of this approach would lead to inconsistent application of a global FCG baseline, as firms can “cherry-pick” which part of the guidance to apply. The second phase of this approach would also be dependent on the number and diversity of firms that have voluntarily adopted and implemented the guidance, in order to have a sufficient basis to further evaluate which aspects of the guidance could become enduring principles to include in the Code. Accordingly, this approach would not achieve the objectives of an FCG framework. Further, a phased approach, while providing much flexibility, would likely take too long to

achieve widespread uptake in firms across jurisdictions because adoption in the initial phase would be entirely voluntary.

- Threshold approach, where an FCG framework in the Code would only be applicable to firms that meet certain criteria, such as firms that (i) perform “public interest work,” (ii) are of a certain size, or (iii) provide professional services to public interest entities (PIEs).

The rationale for this approach is to better target the framework to the universe of firms for which ethical failures have been especially damaging.

PT Response

The PT notes that this approach would lead to inconsistent application of a global baseline for firms against which to assess their FCG practices, as many firms would be scoped out.

Further, it would lead to a two-tiered approach to mindset, behaviors and practices within firms, whereby there would be lower expectations for certain firms (e.g., it would imply, for example, that ethical leadership, accountability, or education and training are not relevant for an SMP or for firms not performing public interest work). Indeed, a few participants from firms in the FCG dialogues commented that this approach would detract from proportionality, as it is about *how* firms can implement FCG according to their circumstances, not about lowering expectations.

Accordingly, this approach would not achieve the key objectives of an FCG framework. However, as noted in the discussion about the target audience for an FCG framework above, there may be aspects of some FCG elements that may lend themselves well to the application of a threshold. Examples that the IESBA might consider include recruiting independent non-executives (INEs) and external transparency about a firm’s ethical policies and practices.

- ISQM 1 approach, where ISQM 1 is used as a vehicle to incorporate material on ethical culture.

The rationale for this approach is premised on the view that ISQM 1 sufficiently addresses the substance of an FCG framework.

PT Response

The PT does not believe that this approach would meet the objectives of the project given the different objectives and scope of ISQM 1 and an FCG framework. ISQM 1 is focused on a firm’s responsibilities to design, implement and operate a system of quality management to support the consistent performance of quality engagements for those engagements within the scope of ISQM 1. The FCG framework is focused on enabling a firm to build and sustain a strong ethical culture at all levels within the firm and across all its services.

Importantly, across jurisdictions, there are large numbers of firms that are outside the scope of the IAASB’s engagement standards. These firms would not be covered if the framework were to be addressed through ISQM 1 as ISQM 1 only addresses engagements within the scope of the IAASB’s engagement standards. By contrast, the scope of the FCG framework is intended to encompass all firms.

In the FCG dialogues, some regulatory participants also did not believe that this approach would achieve the objectives of an FCG framework.

IV. Options for the Way Forward Regarding an FCG Framework – Location and Related Authority

43. The PT notes that there are many possible options for the development of an FCG framework within or outside the Code. The PT has identified five key Options that, in the view of the PT and the Board Advisors, are most representative of the range of possible options. In identifying those five Options, the PT has taken into account the rich and diverse feedback obtained through the FCG dialogues across the range of stakeholders, as summarized in **Agenda Item 2**. However, the PT did not consider the findings from the simulation exercises given the timing of the finalization of the report on the simulations. The Options, ranging from comprehensive changes to the Code to purely educational NAM, are summarized below:

Within the Code

- **Option 1:** Adding the FCG elements that are missing from paragraphs 120.13 A1 to A3.
- **Option 2:** New provisions addressing FCG in Section 300, including an overarching requirement or application material (AM) and the eight FCG elements, along with a cross reference in Section 120 to Section 300.
- **Option 3:** A new section in Part 3 (e.g., new Section 305) containing an FCG framework with requirements and AM addressing the eight FCG elements.

Outside the Code

- **Option 4:** Having the FCG framework outside the Code, addressing the eight FCG elements and available for voluntary adoption.
- **Option 5:** Practical NAM on FCG.

44. The options are not intended to be mutually exclusive or standalone. For example, Option 5 could be combined with any of the other options.
45. In the analysis below, the PT has set out the advantages and disadvantages of each option, independent of stakeholder feedback. Additional considerations on three approaches discussed in Section III (hybrid, phased, and threshold approaches, as relevant) are also set out under each option.

OPTION 1

Adding the FCG elements that are missing from paragraphs 120.13 A1 to A3.

46. Certain FCG elements are not addressed in paragraphs 120.13 A1 to A3 (e.g., independent input, transparency) and others are only partially touched upon. See paragraph 20 above for a gap analysis of the eight FCG elements with the extant Code. This option would add the missing elements into the existing material in the Code.

47. Considerations include:

Advantages	Disadvantages
<ul style="list-style-type: none">• Consolidates the eight elements of an FCG framework as a global baseline in a clear and comprehensive way• Provides a basis for further guidance to be developed outside the Code• Facilitates greater consistency of application of the framework as it sits inside the Code	<ul style="list-style-type: none">• Section 120 applies to all PAs. However, the scope of the FCG project does not include PAs in business.

48. The PT believes that this option is not viable as it goes beyond the scope of the FCG project (i.e., it would involve proposing changes to the Code applicable to PAs in business). One way that this issue might be overcome would be to add a new paragraph after paragraph 120.13 A2 – under a separate subheading applying to firms only – where the missing FCG elements would be mentioned. However, spreading the FCG elements throughout separate subsections could detract from the notion of an integrated framework and hinder holistic interpretation of the framework. Accordingly, the PT does not support this option.
49. The PT believes that Options 2-5 discussed below are more viable but come with different considerations, including different advantages and disadvantages.

OPTION 2

New provisions addressing FCG in Section 300, including an overarching requirement or AM and the eight FCG elements, along with a cross reference in Section 120.

50. The new provisions on FCG would be located right after paragraph R300.4 in the extant Code to make it clear that individual PAs' compliance with the five fundamental principles in the Code does not occur in isolation from their surroundings but is greatly influenced by the culture in the firm. Under this option:
- A new overarching provision would be added after this paragraph to highlight the importance of a firm having an ethical culture. This overarching provision could be a requirement or application material (AM). The IESBA might consider that specifying an overarching requirement would effectively bring the Code up to where ISQM 1 is, given the premise in ISQM 1 regarding the existence of an ethical culture throughout the firm which enables the firm to demonstrate a commitment to quality.⁹
 - In addition, AM would be added to highlight the eight elements that collectively contribute to a firm's ethical culture.

The PT has included an illustration of this Option (for the IESBA's reference only) in **Appendix 2**.

⁹ ISQM 1, paragraph 28(a)(ii)

51. Since paragraph R300.4 refers to a PA's compliance with the fundamental principles in Section 110 and the application of the conceptual framework in Section 120, this option would follow the building blocks approach of the Code by building on the existing high-level material on organizational culture set out in Section 120.
52. Accordingly, a pointer in Section 120 would be added to cross-reference to Section 300 for firm culture and governance under a new proposed subheading "Considerations for All Professional Services" to be located before the extant subheading "*Considerations for Audits, Reviews, Other Assurance and Related Services Engagements*" (extant paragraph 120.14 A1). This would be similar to the existing pointer to ISQM 1 in Section 120.
53. The PT is aware that extant Section 300 includes two paragraphs – 300.5 A2 and 300.7 A5 – that already mention some FCG elements and could in theory be amended to add the missing FCG elements. However, the PT recommends adding new provisions instead of amending the extant ones for the following reasons:
- Paragraph 300.5 A2 focuses on the seniority of the PA and how the more senior their position, the greater their ability to access information in the firm and therefore to positively influence the firm's ethical culture.¹⁰

Amending this provision would not be as effective as positioning new provisions addressing an FCG framework immediately after paragraph R300.4 as explained in paragraph 50 above. However, paragraph 300.5 A2 could be used as a basis for developing those new provisions and deleted as a result.
 - Paragraph 300.7 A5 is focused on the PA's evaluation of the level of a threat to compliance with the fundamental principles. It is not specifically focused on the establishment of an ethical culture within the firm.¹¹

¹⁰ Paragraph 300.5 A2 reads as follows:

The more senior the position of a professional accountant, the greater will be the ability and opportunity to access information, and to influence policies, decisions made and actions taken by others involved with the firm. To the extent that they are able to do so, taking into account their position and seniority in the firm, accountants are expected to encourage and promote an ethics-based culture in the firm and exhibit ethical behavior in dealings with individuals with whom, and entities with which, the accountant or the firm has a professional or business relationship in accordance with paragraph 120.13 A3. Examples of actions that might be taken include the introduction, implementation and oversight of:

- *Ethics education and training programs.*
- *Firm processes and performance evaluation and reward criteria that promote an ethical culture.*
- *Ethics and whistle-blowing policies.*
- *Policies and procedures designed to prevent non-compliance with laws and regulations.*

¹¹ Paragraph 300.7 A5 reads as follows:

A professional accountant's evaluation of the level of a threat might be impacted by the work environment within the accountant's firm and its operating environment. For example:

- *Leadership of the firm that promotes compliance with the fundamental principles and establishes the expectation that assurance team members will act in the public interest.*
- *Policies or procedures for establishing and monitoring compliance with the fundamental principles by all personnel.*
- *Compensation, performance appraisal and disciplinary policies and procedures that promote compliance with the fundamental principles.*

54. Further considerations include:

Advantages	Disadvantages
<ul style="list-style-type: none"> • Makes it clear what the global baseline expectation for FCG is • Makes it clear that there is an FCG framework as the location gives prominence to the framework since it is concentrated in one section of the Code with a specific cross reference from Section 120 • Option 2 means that the new provisions can be written from the perspective of the firm and the specific expectations for FCG, rather than Option 1 which would be an individual PA's consideration of the organizational culture of their organization when applying the conceptual framework • Facilitates greater consistency of application of the framework as it sits inside the Code • Provides a basis for further guidance to be developed outside the Code 	<ul style="list-style-type: none"> • Lower visibility of the FCG framework compared to Option 3

55. Option 2 could be complemented by NAM setting out practical guidance on the eight FCG elements, i.e., a combination of Options 2 and 5 (i.e., the Hybrid approach, see Section III).

56. In theory, Option 2 with an overarching requirement could incorporate a threshold to make it only applicable for certain firms meeting specific criteria (i.e., the Threshold approach). However, for the reasons discussed in Section III, the PT does not recommend this approach. Nevertheless, as discussed in Section III, there may be aspects of certain FCG elements such as independent input and transparency that may lend themselves to considerations of applying a threshold.

-
- *Management of the reliance on revenue received from a single client.*
 - *The engagement partner having authority within the firm for decisions concerning compliance with the fundamental principles, including any decisions about accepting or providing services to a client.*
 - *Educational, training and experience requirements.*
 - *Processes to facilitate and address internal and external concerns or complaints.*

OPTION 3

New section in Part 3 (e.g., new Section 305) containing an FCG framework with requirements and AM addressing the eight FCG elements.

*(See also **Agenda Item 2B** with the proposed potential viewpoints to form enduring principles of an FCG framework)*

57. This option would mean that a comprehensive FCG framework would be incorporated in the Code. This would enable each of the eight FCG elements to be expanded upon within the Code to provide a common understanding and clear expectations. The PT has included an illustration of this Option (for the IESBA's reference only) in **Appendix 3**.
58. Further considerations include:

Advantages	Disadvantages
<ul style="list-style-type: none"> Makes it clearer that there is a framework addressing FCG as the location gives even more prominence to the framework since it is a new section of the Code as compared to Option 2 Makes it clearer what the global baseline is with greater specificity as compared to Option 2 Facilitates greater consistency of application of the framework as it sits inside the Code 	<ul style="list-style-type: none"> It would be more elaborate and therefore potentially seen as more complex compared to Option 2 May create more of a compliance mindset given that it would contain more requirements than Option 2, which would detract from the key objective of the framework to promote or motivate positive changes in mindset, behaviors and practices within firms that support an ethical culture

59. Option 3 could be complemented by NAM setting out practical guidance on the provisions of the framework, i.e., a combination of Options 3 and 5 (i.e., the Hybrid approach, see Section III).
60. As for Option 2, Option 3 could, in theory, incorporate a threshold to make it only applicable for certain firms meeting specific criteria (i.e., the Threshold approach). However, for the reasons discussed in Section III, the PT does not recommend this approach. Nevertheless, as discussed in Section III, there may be aspects of certain FCG elements, such as independent input and transparency, that may lend themselves to considerations of applying a threshold.

OPTION 4

FCG framework outside the Code, addressing the eight FCG elements and available for voluntary adoption.

(Layout similar to [G20/OECD Principles of Corporate Governance](#) i.e. main principles complemented and supported by detailed explanation/ guidance)

61. Considerations include:

Advantages	Disadvantages
<ul style="list-style-type: none"> • Makes it clear that there is a framework addressing FCG as the location gives prominence to the framework since it is a separate document outside the Code • Makes it clear what the global baseline is in a more detailed fashion, similar to Option 3 • More flexible implementation by firms 	<ul style="list-style-type: none"> • Less authority compared to Options 1-3 since the framework sits outside the Code. This means that it would be dependent on individual jurisdictional regulators to adopt and enforce the framework • Unclear what the extent of uptake would be, as NAM is entirely voluntary. As a consequence, there could be fragmented and inconsistent adoption and implementation of the framework

62. Option 4 could be implemented through a phased approach (see Section III) whereby the FCG framework would first sit outside the Code and after a certain period, the IESBA would assess if and how the framework could be placed inside the Code. This assessment could be done within a process equivalent to a post-implementation review (PIR).

63. As for Options 2 and 3, Option 4 could incorporate a threshold to make it only focused on certain firms meeting specific criteria (i.e., the Threshold approach). However, for the reasons discussed in Section III, the PT does not recommend this approach. Nevertheless, as discussed in Section III, there may be aspects of certain FCG elements, such as independent input and transparency, that may lend themselves to considerations of applying a threshold.

OPTION 5

Compilation of current “good practices” or other practical guidance on FCG.

64. Development of such guidance can be in collaboration with firms and professional accountancy organizations (PAOs).

65. Considerations include:

Advantages	Disadvantages
<ul style="list-style-type: none"> • Such compilation would create in substance a “knowledge sharing repository” that would be well suited to meeting firms’ education and training needs • Provides flexibility to design and target NAM where there would be the greatest impact 	<ul style="list-style-type: none"> • On its own, practical guidance does not constitute a real framework • NAM on its own has less enduring value and authority than provisions in the Code • Unclear extent of uptake as NAM is entirely voluntary

66. Option 5 could be implemented through a phased approach whereby the guidance would be issued and after a certain period, the IESBA would assess if and how it could be transformed into an FCG framework located inside the Code. This assessment could be done within a process equivalent to a PIR. However, see Section III for a discussion of the drawbacks for a phased approach.

V. PT's Recommendation for the Way Forward

67. The PT recommends Option 2 complemented by Option 5. This recommendation also reflects a hybrid approach to the adoption and implementation of an FCG framework.
68. In developing this recommendation, the PT sought to balance:
- The objectives of an FCG framework described in Section I.
 - The range of stakeholder views collected during the FCG dialogues, along with the PT's responses considering the public interest, as discussed in Sections II and III.
 - The analysis of each option as set out in Section IV.
69. The PT notes that the five options presented in Section IV span a spectrum between two contrasting approaches. At one end, Option 3 would establish a comprehensive framework in a new section of the Code, embedding detailed requirements and application material directly within the Code itself. This approach would provide greater specificity for firms and a clearer basis for regulatory enforcement. At the other end, Option 5 would rely solely on practical guidance outside the Code, enabling firms to use such material as they consider appropriate in the context of their needs and circumstances.
70. The PT acknowledges that fostering positive changes in mindset, behavior, and practices within firms to support an ethical culture will require time and sustained effort, as also recognized by some participants in the FCG dialogues. Firms will differ in their starting points and implementation journeys depending on factors such as size, service lines, operating models, and jurisdictions, as well as their implementation (or not) of ISQM 1. Accordingly, any FCG framework should avoid being overly prescriptive. Instead, it should remain principles-based, enabling firms to meet the intent of the principles in a manner that is proportionate and appropriate to their circumstances. At the same time, the PT believes the framework needs sufficient authority and clarity as a global point of reference on FCG to support consistent understanding, application, and enforceability.
71. Against this analysis, the PT considers that Option 2 (new provisions addressing FCG in Section 300 together with a cross-reference in Section 120 to Section 300), combined with Option 5 (development of NAM), strikes the most appropriate balance. Establishing overarching principles and supporting high-level application material addressing the eight FCG elements would create a clear foundation within the Code that could serve as a global baseline for assessing FCG practices across firms and service lines. It would also provide a common understanding of the key elements that underpin a strong ethical culture, while allowing sufficient flexibility for firms to implement the framework in a scalable and proportionate manner.
72. Specifically, the PT views that this recommendation responds to the public interest considerations underpinning the FCG project by:
- Introducing high level, principles-based provisions in the Code that address FCG in a holistic and comprehensive manner.

- Avoiding the unintended consequence of firms turning implementation of the framework into a mechanical and disproportionate compliance exercise, especially those that may already be applying some or all of the eight FCG elements or other existing frameworks.
- Providing firms and PAOs with high-level, principles-based guidance that can support the development of more practical educational and training materials on FCG.
- Establishing sufficient authoritative material to promote greater global consistency in ethical firm culture and enhancing comparability of FCG practices for the benefit of clients of firms, investors and other users of firms' professional services.

Matters for IESBA Consideration

IESBA members are asked to share views on:

- (a) The PT's analysis of the issues and options presented and the PT's recommendation for the way forward; and
- (b) If the Board supports the PT's recommendation, whether the overarching provision under Option 2 should be a requirement or AM.

Appendix 1

Examples of Regulatory Findings where Root Causes Linked to FCG Elements Are Highlighted

Without any intention to single out particular accounting firms, the table below sets out some prominent public regulatory findings involving firms where one or more of the eight FCG elements have been noted as reasons for enabling the ethical failures reported.

Summary of Issue in Regulatory Finding	Excerpts Relevant to FCG
Deloitte Indonesia and Philippines (2024) Widespread answer sharing on internal training tests (April 2024) ¹²	U.S. Public Company Accounting Oversight Board (PCAOB) order noted “an inappropriate tone at the top... and a failure by leadership at both firms to effectively promote an ethical culture among the firms’ personnel with respect to improper answer sharing and monitoring of the firms’ systems of quality control” ¹³ that enabled widespread improper answer sharing.
KPMG Netherlands (2024) Widespread improper answer-sharing at the firm in connection with tests for mandatory training over five years, with multiple misrepresentations made by the firm to the PCAOB about its knowledge of the misconduct (April 2024) ¹⁴	PCAOB order noted “an inappropriate tone at the top” ¹⁵ that “enabled a pervasive problem with the Firm’s culture.” ¹⁶ PCAOB order also noted that part of the supervision program conducted by the Dutch Authority for the Financial Markets (AFM) will include “exploring further appropriate changes to Firm culture.” ¹⁷

¹² Excerpt from [PCAOB News Release](#)

¹³ Excerpt from [PCAOB Release No. 105-2024-025](#), page 5, paragraph 14: “As illustrated by the misconduct described above, from at least 2017 to 2019, DT Philippines’s inappropriate tone at the top enabled widespread improper answer sharing with respect to internal training tests.”

¹⁴ Excerpt from [PCAOB News Release](#)

¹⁵ Excerpt from [PCAOB Release No. 105-2024-022](#), page 3, paragraph 3: “This misconduct revealed an inappropriate tone at the top of the Firm and a failure by Firm leadership to effectively promote an ethical culture among Firm personnel with respect to improper answer sharing and monitoring of the Firm’s system of quality control.”

¹⁶ Excerpt from [PCAOB Release No. 105-2024-022](#), page 11, paragraph 38: “As illustrated by the failures and misconduct described above, from at least October 2017 to December 2022, an inappropriate tone at the top enabled a pervasive problem with the Firm’s culture, resulting in widespread improper answer sharing with respect to professional training tests.”

¹⁷ Excerpt from [PCAOB Release No. 105-2024-022](#), pages 11-12: “The Board understands that this supervision program will include remediation, conducting a root cause analysis, establishing policies and procedures to prevent and detect improper answer sharing at the Firm, and exploring further appropriate changes to Firm culture.”

Summary of Issue in Regulatory Finding	Excerpts Relevant to FCG
<p>PwC Australia (2023)</p> <p>Misuse of confidential Australian Government information by partners and employees of the multidisciplinary firm PwC Australia. (June 2023)¹⁸</p>	<p>The June 2023 Senate report noted that this matter “speaks to poor corporate culture and a lack of decent governance and accountability.”¹⁹</p> <p>The November 2024 Parliamentary Joint Committee report noted that there has been “inadequate attention to building and maintaining an ethical culture.”²⁰</p>
<p>Ernst & Young LLP (2022)</p> <p>Cheating by its audit professionals on exams required to obtain and maintain Certified Public Accountant (CPA) licenses and for withholding evidence of this misconduct from the SEC’s Enforcement Division during the Division’s investigation of the matter. (June 2022)²¹</p>	<p>The US SEC Order found that EY violated a PCAOB rule requiring the firm to maintain integrity in the performance of professional service, committed acts discreditable to the accounting profession, and failed to maintain an appropriate system of quality control.²²</p> <p>The US SEC order²³ further states that EY’s evaluation shall include assessing:</p> <p>“a. the adequacy and sufficiency of ethics and integrity training and guidance, including regarding anti-retaliation and whistleblowing;</p> <p>b. whether EY’s culture is supportive of ethical and compliance conduct and maintaining integrity, including strong, explicit, and visible support and commitment by the firm’s management;</p> <p>...</p>

¹⁸ Excerpt from [IESBA Firm Culture and Governance Working Group Final Report](#), Appendix 8

¹⁹ Excerpt from the [Senate report, June 2023](#), page 18, 1.112: “As a tax agent and a provider of consulting services for government, PwC is in a fundamentally conflicted position. PwC’s failure to recognise and manage this conflict speaks to poor corporate culture and a lack of decent governance and accountability.”

²⁰ Excerpt from the [Parliamentary Joint Committee report, November 2024](#), page 16: “Based on a review of the information available relating to these matters and the Firm’s response to them, it is apparent that: ... There has been inadequate focus on identifying and addressing actual or apparent conflicts of interest and sensitive situations and inadequate attention to building and maintaining an ethical culture ...”

²¹ Excerpt from [US SEC Press Release](#)

²² Excerpt from [US SEC Press Release](#)

²³ <https://www.sec.gov/files/litigation/admin/2022/34-95167.pdf>, page 10, paragraph 38

Summary of Issue in Regulatory Finding	Excerpts Relevant to FCG
	d. whether EY has designed and implemented appropriate policies and procedures and deploys proper resources and oversight ..., including (i) monitoring to detect compliance; (ii) having appropriate reporting lines, compensation, and rewards; (iii) assigning responsibility for overseeing compliance to senior executives and managers with access to relevant information and personnel; and (iv) ensuring consistent discipline.”
<p>Grant Thornton UK (2021)</p> <p>Audit work which involved numerous breaches of relevant requirements, evidencing a serious lack of competence in conducting the audit work, missed red flags, a failure to obtain sufficient audit evidence and a failure to stand back and question information provided by management (September 2021) ²⁴</p>	<p>UK FRC report noted GT’s remedial actions include for GT to “undertake a review of the audit practice’s culture relating to challenge.” ²⁵</p>
<p>KPMG LLP (2019)</p> <p>Altering past audit work after receiving stolen information about inspections of the firm that would be conducted by the PCAOB, and cheating on internal training exams by improperly sharing answers and manipulating test results (June 2019) ²⁶</p>	<p>According to the US SEC Order, senior personnel sought and obtained confidential PCAOB lists of inspection targets because the firm had experienced a high rate of audit deficiency findings in prior inspections and improvement had become a priority.²⁷</p> <p>The US SEC Order also found that KPMG audit professionals who had passed training exams sent their answers to colleagues to help them also attain passing scores, and that certain KPMG audit professionals manipulated an</p>

²⁴ Excerpt from [UK FRC News](#)

²⁵ Excerpt from [Executive Counsel's Final Decision Notice](#), pages 8-9, paragraphs 2.17.4 and 2.17.4.2: “Non-financial sanctions, in the form of an order pursuant to Rule 96(c) of the AEP, requiring GT to take remedial action to prevent the recurrence of the breaches: ... GT to undertake a review of the audit practice’s culture relating to challenge and to provide a report and proposed actions to the FRC’s Executive Counsel and Executive Director of Supervision.”

²⁶ Excerpt from [US SEC Press Release](#)

²⁷ Excerpt from [US SEC Press Release](#)

Summary of Issue in Regulatory Finding	Excerpts Relevant to FCG
	<p>internal server hosting training exams to lower the score required for passing.²⁸</p> <p>The US SEC order²⁹ further states KPMG’s evaluation shall include assessing:</p> <p>“a. the adequacy and sufficiency of ethics and integrity training and guidance, including regarding anti-retaliation and whistleblowing;</p> <p>b. whether KPMG’s culture is supportive of ethical and compliant conduct, including strong, explicit, and visible support and commitment by the firm’s management and Board of Directors; and</p> <p>c. whether KPMG deploys proper resources and oversight for compliance with ethics and integrity requirements, including seniority of executives and managers responsible for implementation and oversight of these responsibilities, reporting lines, autonomy and independence, compensation and rewards, consistent discipline, access to information and personnel.”</p>

²⁸ Excerpt from [US SEC Press Release](#)

²⁹ <https://www.sec.gov/files/litigation/admin/2019/34-86118.pdf>, page 15, paragraph 65

Appendix 2

For Reference Only – Illustration of Option 2 Not Intended for Discussion or Comment

The PT developed an illustrative example to help the IESBA visualize how Option 2 might be incorporated into the Code (*see text in purple*). This illustration includes:

- A. A cross reference from Section 120 (first box below), which would be introduced along with either:
- B. An overarching provision and the eight FCG elements as a requirement and application material, respectively (second box below); or
- C. An overarching provision and the eight FCG elements as application material (third box below).

The illustration is not intended for the solicitation of comments from the IESBA. Should the IESBA determine that Option 2 is the appropriate way forward, the PT would subsequently further develop a draft on which it would seek the IESBA's input.

Although “independent input” is one of the eight FCG elements, the PT has used the term “impartial input” to better describe the intended substance of the input and to address stakeholder perceptions that the term could imply a requirement for all firms to appoint independent non-executives.

A. Proposed New Cross Reference from Section 120

SECTION 120

...

Other Considerations when Applying the Conceptual Framework

...

Organizational Culture

120.13 A1 The effective application of the conceptual framework by a professional accountant is enhanced when the importance of ethical values that align with the fundamental principles and other provisions set out in the Code is promoted through the internal culture of the accountant's organization.

120.13 A2 The promotion of an ethical culture within an organization is most effective when:

- (a) Leaders and those in managerial roles promote the importance of, and hold themselves and others accountable for demonstrating, the ethical values of the organization;
- (b) Appropriate education and training programs, management processes, and performance evaluation and reward criteria that promote an ethical culture are in place;
- (c) Effective policies and procedures are in place to encourage and protect those who report actual or suspected illegal or unethical behavior, including whistle-blowers; and
- (d) The organization adheres to ethical values in its dealings with third parties.

- 120.13 A3 Professional accountants are expected to:
- (a) Encourage and promote an ethics-based culture in their organization, taking into account their position and seniority; and
 - (b) Exhibit ethical behavior in dealings with individuals with whom, and entities with which, the accountants, the firm or the employing organization has a professional or business relationship.

Considerations for All Professional Services (Proposed New)

Firm Culture and Governance

- 120.14 A1 Section 300 sets out application material relating to the promotion of an ethical culture within a firm.

Considerations for Audits, Reviews, Other Assurance and Related Services Engagements

Firm Culture

- 120.1415 A1 ISQM 1 sets out requirements and application material relating to firm culture in the context of a firm's responsibilities to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements.

Independence

...

B. Proposed New Provisions in Section 300 with the Overarching Provision as a Requirement

SECTION 300

...

- 300.3 In this Part, the term "professional accountant" refers to individual professional accountants in public practice and their firms.

...

General

...

- R300.4** A professional accountant shall comply with the fundamental principles set out in Section 110 and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to compliance with the fundamental principles.

- 300.4 A1 A firm's culture influences the mindset, behaviors and judgments of its leaders and staff and therefore can impact their application of the conceptual framework and, ultimately, their compliance with the fundamental principles.

- R300.5** Leaders in the firm shall promote an ethical culture within the firm.

- 300.5 A1 Key factors that help to support an ethical culture include:
- A firm having ethical values that align with the fundamental principles and other provisions in the Code.

- Leaders setting the tone at the top through exhibiting ethical behavior in their judgments, decisions and actions.
- Oversight and governance embedding the ethical values of the firm and monitoring adherence to them irrespective of changes in leadership.
- Leaders considering obtaining impartial input on the firm's strategic and governance matters, recognizing that the source of such input reflects the firm's characteristics and circumstances, including the level of public interest in its engagements.
- Leaders and staff holding themselves accountable for demonstrating the firm's ethical values.
- Performance evaluation and reward criteria promoting an ethical culture.
- Unethical behavior of leaders and staff being addressed in a timely manner through appropriate disincentives.
- The firm's operating environment encouraging open discussion and challenge without fear of retribution or retaliation.
- Leaders and staff undergoing ethics education and training programs that enable them to have a continuing awareness and understanding of ethical developments relevant to their professional activities.
- Leaders being transparent within the firm about their decisions and actions to promote and uphold the firm's ethical values.
- Leaders considering publicly disclosing relevant information on how the firm demonstrates its ethical values, depending on the firm's characteristics and circumstances, including the level of public interest in its engagements.

...

C. Proposed New Provisions in Section 300 with the Overarching Provision as Application Material

SECTION 300

...

300.3 In this Part, the term “professional accountant” refers to individual professional accountants in public practice and their firms.

...

General

...

R300.4 A professional accountant shall comply with the fundamental principles set out in Section 110 and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to compliance with the fundamental principles.

300.4 A1 A firm's culture influences the mindset, behaviors and judgments of its leaders and staff and therefore can impact their application of the conceptual framework and, ultimately, their compliance with the fundamental principles.

- 300.4 A2 Key factors that help to support an ethical culture include:
- A firm having ethical values that align with the fundamental principles and other provisions in the Code.
 - Leaders setting the tone at the top through exhibiting ethical behavior in their judgments, decisions and actions.
 - Oversight and governance embedding the ethical values of the firm and monitoring adherence to them irrespective of changes in leadership.
 - Leaders considering obtaining impartial input on the firm's strategic and governance matters, recognizing that the source of such input reflects the firm's characteristics and circumstances, including the level of public interest in its engagements.
 - Leaders and staff holding themselves accountable for demonstrating the firm's ethical values.
 - Performance evaluation and reward criteria promoting an ethical culture.
 - Unethical behavior of leaders and staff being addressed in a timely manner through appropriate disincentives.
 - The firm's operating environment encouraging open discussion and challenge without fear of retribution or retaliation.
 - Leaders and staff undergoing ethics education and training programs that enable them to have a continuing awareness and understanding of ethical developments relevant to their professional activities.
 - Leaders being transparent within the firm about their decisions and actions to promote and uphold the firm's ethical values.
 - Leaders considering publicly disclosing relevant information on how the firm demonstrates its ethical values, depending on the firm's characteristics and circumstances, including the level of public interest in its engagements.

...

Appendix 3

For Reference Only – Illustration of Option 3 Not Intended for Discussion or Comment

Based on the potential enduring principles for an FCG framework identified in **Agenda Item 2B**, the PT has developed an illustrative example to help the IESBA visualize how Option 3 might be incorporated into the Code. This is an illustration of a new Section 305 containing an FCG framework with requirements and AM addressing the eight FCG elements.

The illustration is not intended for the solicitation of comments from the IESBA. Should the IESBA determine that Option 3 is the appropriate way forward, the PT would subsequently further develop a draft on which it would seek the IESBA's input.

Although “independent input” is one of the eight FCG elements, the PT has used the term “impartial input” to better describe the intended substance of the input and to address stakeholder perceptions that the term could imply a requirement for all firms to appoint independent non-executives.

SECTION 305

FIRM CULTURE AND GOVERNANCE

Introduction

305.1 A firm's culture influences how leaders and staff comply with the fundamental principles and apply the conceptual framework.

Requirements and Application Material

General

R305.2 Leaders in the firm shall promote a culture that supports its personnel in complying with the fundamental principles and applying the conceptual framework set out in Section 120 to identify, evaluate and address threats.

Ethical Leadership

R305.3 Leaders in the firm shall align their decisions, conduct, and the firm's overall business strategy with the firm's ethical values.

305.3 A1 A firm's ethical values are most effective when they are consistent with the fundamental principles and other provisions in the Code.

305.3 A2 Actions that support aligning decisions, conduct and business strategy with the firm's ethical values include, for example:

- Setting an appropriate tone at the top that promotes ethical behavior throughout the firm.
- Embedding the firm's ethical values in the firm's governance, systems, policies, and procedures to reduce the risk of ethical failures.
- Recognizing the value of impartial input on strategic and governance matters and seeking such input as needed.
- Recruiting and promoting individuals who demonstrate behavior consistent with the firm's ethical values.

- Designing incentives that promote behavior consistent with the firm's ethical values.
- Holding leaders and staff accountable for behavior that breach the firm's ethical values.

Oversight and Governance

R305.4 Oversight of ethical conduct and culture within a firm shall be assigned to an individual or group of individuals with the appropriate authority for decision-making on matters of ethical conduct.

305.4 A1 A firm governance structure that oversees ethical culture is most effective when:

- It is not dependent on or affected by changes in leadership.
- There are clearly defined roles and responsibilities of leaders.
- There are mechanisms that promote accountability of leaders and staff in accordance with the firm's ethical values.
- There are policies and processes designed to embed the firm's ethical values in decision-making.

Impartial Input

R305.5 Leaders in the firm shall consider obtaining impartial input on the firm's strategic and governance matters.

305.5 A1 Impartial input enables the firm's decision-making to reflect broader stakeholder considerations and the public interest.

305.5 A2 Policies and processes designed to identify the circumstances where impartial input should be sought promote a clear and consistent approach to determining when such input is needed.

305.5 A3 Effective impartial input involves selecting individuals or entities with the relevant skills, knowledge and experience who are independent and not compromised by conflicts of interest.

Accountability Across the Firm

R305.6 Leaders in the firm shall establish the responsibility of each member of personnel to adhere to the Code and uphold the firm's ethical values from the moment they join the firm, regardless of their role and seniority.

305.6 A1 Performance evaluations that assess the behavior of leaders and staff against the firm's ethical values promote accountability across the firm.

Incentives and Disincentives

R305.7 Leaders in the firm shall design and implement incentives and disincentives that reinforce ethical behavior and reduce the risk of behavior inconsistent with the firm's ethical values.

305.7 A1 Incentives and disincentives are most effective when they:

- Recognize and reward behavior consistent with the firm's ethical values.
- Promote the understanding that all leaders and staff are accountable for upholding the firm's ethical values.
- Establish clear consequences for behavior inconsistent with the firm's ethical values.

Open Discussion and Challenge

R305.8 Leaders in the firm shall promote open discussion and challenge by fostering an environment of mutual respect and trust.

305.8 A1 A culture of open discussion and challenge is most effective when:

- Leaders and staff are empowered to voice their perspectives and concerns about ethics-related matters without fear of adverse consequences.
- Mechanisms are established to resolve differences of opinion, and to facilitate the communication of ethics-related matters.

Education and Training

R305.9 Leaders in the firm shall establish policies and procedures for mandatory and regular ethics education and training programs for all leaders and staff.

305.9 A1 An ethics education and training program is most effective when:

- It promotes decision-making on ethical matters as a core professional competence.
- There is appropriate involvement from the firm's leaders.
- It is regularly updated to incorporate developments in the Code and other relevant ethical standards, policies, rules and regulations.

Transparency

305.10 A1 Leaders in the firm who exhibit transparency about their decisions and actions throughout the firm can:

- Promote the firm's ethical values.
- Foster an appropriate tone at the top.
- Demonstrate accountability for their decisions and actions.
- Contribute to fostering a culture of open discussion and challenge within the firm.

305.10 A2 Leaders may consider publicly disclosing relevant information on how the firm demonstrates its ethical values, depending on the firm's characteristics and circumstances, including the level of public interest in its engagements.