Firm Culture and Governance (FCG)

Proposed FCG Provisions – Second Read

Mark-Up from September 2026 IESBA Meeting Agenda Item 2A (Turnaround)

SECTION 300

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300.4 A1 Compliance with the fundamental principles and the application of the conceptual framework within a firm are influenced by its ethical culture and related governance. Such culture and governance play an important~~significant~~ role in shaping the mindset, behaviors and judgments of a firm's personnel, and help them to meet their responsibility to act in the public interest.

Revised proposed 300.4 A1 – Bridge provision to explain why the culture and governance of a firm are relevant to an individual's compliance with the fundamental principles

At the September 2026 meeting, a view was expressed that this proposed provision should not only explain the internal value of firm culture and governance but also highlight its value to stakeholders.

The Project Team (PT) and Board Advisors (BAs) note that the revised draft of the overarching requirement discussed on the final day of the September Board meeting addressed this external value through the following phrase intended to convey the ultimate purpose of the FCG provisions: "*…thereby contributing to public trust in the profession.*" However, IESBA members expressed mixed views on whether this should be stated explicitly in the requirement:

- Some considered it implicit in the reference to *"…compliance with the fundamental principles"* in the proposed requirement and therefore unnecessary to state separately. It was also noted that the term "public trust" appears only in the description of IESBA's mission and not within the extant Code provisions.
- Others supported this statement but suggested using "public interest" instead of "public trust," consistent with a professional accountant (PA)'s responsibility to act in the public interest (extant paragraph 100.6 A1).

The PT and BAs believe it is important to emphasize the *purpose* of the FCG provisions but consider proposed paragraph 300.4 A1 the more appropriate place to do so. This would then supplement the explanation of *why* the FCG provisions are needed and *how* they connect to the fundamental principles.

Accordingly, the ultimate purpose of the FCG provisions (i.e., the external value it brings to stakeholders) has been moved to proposed paragraph 300.4 A1, with wording changed from "public trust in the profession" to "responsibility to act in the public interest" to align with the extant Code.

Other proposed changes to this provision include:

- Adding "related" before "governance" to clarify that the FCG provisions address only governance relevant to establishing and maintaining an ethical culture.
- Replacing "significant" with "important" in response to stakeholder feedback during Q4 outreach that

"significant" could overstate the role of the firm's ethical culture and related governance relative to other influences shaping the mindset, behaviors and judgments of a firm's personnel.

Stakeholder feedback during Q4 outreach also observed that "are influenced" in the proposed provision could give the impression that a firm's culture, if unethical, would always lead its personnel to act unethically. They noted that this is not necessarily the case and individuals can demonstrate courage and act ethically despite such pressures. The PT and BAs consider that "influence" means to affect or shape, rather than determine, an individual's behavior. Therefore, the PT and BAs propose no change.

Ethical Culture and Related Governance within Firms

R300.5 A firm shall take appropriate steps~~, including governance arrangements,~~ to establish and maintain an ~~effective~~ ethical culture throughout the firm that supports compliance with the fundamental principles by its personnel~~, thereby contributing to public trust in the profession~~. In doing so, the firm shall exercise professional judgment, taking into account the nature and circumstances of the firm and its professional services. Ethical leadership and governance are key drivers to establishing and maintaining such an ethical culture.

300.5 A1 The ultimate responsibility for establishing and maintaining an ethical culture and related governance rests with the firm's leadership, such as the senior or managing partner (chief executive or equivalent) ~~and~~or, if ~~applicable~~appropriate, the managing board of partners (or equivalent). However, all personnel have a role in ~~shaping and embodying~~contributing to and reinforcing the ethical culture of the firm.

300.5 A2 ~~The establishment and maintenance of a~~An ethical culture and related governance are more likely to support compliance with the fundamental principles when the firm takes appropriate steps in relation to ~~is most effective when it involves~~ the following ~~eight~~ interconnected elements:

- *Ethical leadership:* The firm's leadership setting the tone at the top and every leader at all levels within the firm ~~embodying~~ demonstrating ethical behavior in their judgments, decisions and actions, thereby setting the expectation for all personnel to ~~comply with the fundamental principles~~ act ethically.
- *Oversight and governance arrangements:* The firm's leadership establishing and maintaining arrangements that effectively monitor ~~adherence to the Code~~the ethical culture throughout the firm and embed ethics in conduct and decision-making.
- *Independent input:* For significant strategic, governance and business decisions of the firm on matters involving the public interest, considering obtaining input from individual(s) or other sources that~~who~~ are impartial and free from actual or perceived conflicts of interest with respect to such matters.
- *Accountability across the firm:* Setting clear expectations for all personnel to act ethically ~~in accordance with the fundamental principles~~ and holding all personnel responsible for meeting those expectations.
- *Incentives and disincentives*
    - *Incentives:* Designing and implementing performance evaluation and compensation practices that ~~consider~~ reinforce ethical behavior alongside

financial targets and do not motivate personnel to act unethically.

- *Disincentives:* Deterring unethical behavior and responding to it in a consistent and timely manner with appropriate communications, measures and consequences.

- *Open discussion and challenge:* Fostering an environment where personnel feel safe to discuss ethics-related matters, raise concerns or challenge decisions from an ethical perspective without fear of adverse consequences.
- *Education and training:* Taking appropriate steps to regularly educate and train personnel to develop an ethical mindset and professional judgment that helps them identify and address ethical dilemmas when performing their professional activities.
- *Transparency*
  - *Internal transparency:* Sharing ethics-related learnings and experiences within the firm, as appropriate, to reinforce the importance of ethical behavior.
  - *External transparency:* Considering publicly disclosing relevant information on how the firm demonstrates its commitment to establishing and maintaining an ethical culture and governance throughout the firm.

300.5 A3 The steps under paragraph R300.5 that the firm might take in relation to the elements referred to in paragraph 300.5 A2 and how they are implemented will vary according to the firm's naturecharacteristics and circumstances of the firm. Relevant Ffactors the firm might to consider include:

- The size and structure of the firm.
- The size and nature of the firm's client base.
- The nature of the professional services provided by the firm.
- Whether the firm is part of a network and considerations that might be relevant in establishing and maintaining an ethical culture in such circumstances.

300.5 A4 The nature and circumstances of the firm Such considerations are particularly relevant, especially for sole practitioners and small and medium practices including sole practitioners, when determining:

- The type of arrangement(s) for oversight and governance.
- If independent input is sought, the source(s) of that input.

Proposed paragraph R300.5 – Overarching requirement

At the September 2026 meeting, IESBA members expressed mixed views on the following key aspects of the proposed requirement:

- "Appropriate steps" – Some were in favor of this wording to support enforceability and proportionality, while others considered it too weak as it could imply that taking steps alone satisfies the requirement, regardless of whether the intended outcome is achieved.

- "Including governance arrangements" following "appropriate steps" –
    - Some supported this formulation to highlight governance's role in establishing and maintaining an ethical culture without overemphasizing it.
    - Some considered that governance arrangements (formal or informal) are at the heart of how an organization is directed and how culture is shaped, and therefore should be the focal point of the requirement.
    - Others considered an explicit reference to governance unnecessary in the requirement as it is already specified in one of the eight FCG elements.
- "Effective" – Some questioned the relationship of the term "effective" with the superlative adjective "most effective" in the lead-in of proposed paragraph 300.5 A2, which introduces the FCG elements, and whether that inadvertently created a hidden requirement for the FCG elements. They also considered that using the term "effective" in the requirement is inconsistent with other references to ethical culture in the extant Code. There was a view that it is unnecessary in the requirement, as the outcome of an ethical culture, i.e., to support compliance with the fundamental principles, was already set out in the requirement. A view was also expressed in favor of retaining the term in the requirement, noting its use in international regulatory principles and assessment methodologies.

Having reflected on the range of views, the PT and BAs considered the drafting approach taken in paragraph 19 of ISQM 1,[1] which requires a firm to design, implement and operate a system of quality management. The PT and BAs believe that adopting this approach would represent a good compromise while preserving the intent and substance of the proposed requirement:

- The first sentence contains the main requirement, i.e., the obligation for a firm to take appropriate steps to establish and maintain an ethical culture throughout the firm.

  The PT and BAs propose retaining "appropriate steps" as it signals a call to action for firms and contributes to the enforceability of the requirement as regulators can evaluate which steps the firms have undertaken. This wording is also already used in other requirements in the extant Code (e.g., paragraphs R220.7, R220.8, R260.14). Further, it also speaks to scalability and proportionality as there is no one-size-fits-all – each firm will need to implement the requirement through steps *appropriate* to the firm's nature and circumstances (re-emphasized in the second sentence).

  The reference to "effective" was removed along with changes proposed to paragraph 300.5 A2 (in particular, the proposal to remove "most effective"). Under the reformulated requirement, an (effective) ethical culture is already described by the reference to its outcome, which is to support compliance with the fundamental principles at the end of the first sentence.
- The second sentence aligns with the second sentence of paragraph 19 of ISQM 1 and reinforces proportionality by requiring the exercise of professional judgment in identifying and carrying out

[1] International standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements,* paragraph 19 states:

> "*The firm shall design, implement and operate a system of quality management. In doing so, the firm shall exercise professional judgment, taking into account the nature and circumstances of the firm and its engagements. The governance and leadership component of the system of quality management establishes the environment that supports the design, implementation and operation of the system of quality management.*"

the appropriate steps, taking into account the nature and circumstances of the firm and its professional services, as further explained in proposed paragraphs 300.5 A3 and A4. The PT and BAs also note that an explicit requirement for a firm to exercise professional judgment is consistent with the extant Code (e.g., paragraphs R400.80 and R900.50).

- The third sentence is essential explanatory material that highlights the two characteristics of FCG – ethical leadership and governance – that are key drivers[2] of an ethical culture. This responds to IESBA members' feedback at the September 2026 meeting to include such explanation. Importantly, it balances recognizing the crucial role of governance in supporting an ethical culture without introducing it through a "shall" requirement that might be seen as prescriptive and potentially blurring the line with the FCG element of "oversight and governance."

The PT and BAs believe that aligning the phraseological structure and wording used in the overarching requirement to ISQM 1's paragraph 19, which is well-established and already implemented across firms globally, enhances the clarity of the intent behind the overarching requirement and supports interoperability between both standards.

The PT and BAs also considered a question raised during the September 2026 meeting about whether every breach of a fundamental principle would automatically constitute a breach of the overarching requirement. The PT and BAs considered that it would not. An individual breach might suggest a deeper problem with the firm's ethical culture and related governance, but this would not necessarily mean that the firm has not taken appropriate steps to establish and maintain an ethical culture, just as an identified deficiency in a firm's system of quality management does not automatically mean that the firm has not designed, implemented and operated such a system as required by ISQM 1.

Instead, an ex-post breach of a fundamental principle would provide reason and opportunity for the firm to evaluate where improvements could be made in its ethical culture, having already taken appropriate steps to establish and maintain it. The PT and BAs believe it is important to bear in mind that an ethical culture is not a guarantee that there will be no future breaches of the fundamental principles. Rather, an ethical culture provides a strong safeguard against such breaches.

Proposed paragraph 300.5 A1 – Ultimate responsibility for the firm's ethical culture and related governance

At the September 2026 meeting, mixed views were expressed on whether ultimate responsibility should rest with the firm's leadership, as described in the proposed provision, or with the firm, leaving it to determine how responsibilities are allocated. A concern was also raised that addressing the requirement to the firm while assigning ultimate responsibility to its leadership could create confusion.

The PT and BAs note that, as explained previously in Agenda Item 2A Proposed FCG Provisions – First Read, this proposed provision is intended to provide clarity regarding who in the firm bears ultimate responsibility for meeting the requirement, which is the firm's leadership. Therefore, the proposed wording is retained.

In the second sentence, the PT and BAs propose replacing "shaping and embodying" with "contributing to and reinforcing" in the last sentence. This change aims to respond to comments from a few IESBA

[2] The wording used ("key drivers") is based on the overarching piece that preceded the IESBA FCG viewpoints, see paragraph 42 (on page 11) of the briefing note.

members that words such as "shape" and "embody" may be difficult to translate into other languages.

The PT and BAs also considered feedback from the September 2026 meeting that firms can have various forms of leadership structures, and leadership could rest with individuals or bodies other than those listed in the proposed provision. The PT and BAs acknowledge this and note that "such as" makes the list non-exhaustive. In addition, the words "or equivalent" accommodate alternative titles and bodies.

Proposed paragraph 300.5 A2 – Description of the elements of an ethical culture and related governance

At the September 2026 meeting, IESBA members shared the following key comments on this proposed provision:

- The lead-in as drafted risked being interpreted as a requirement because "most effective when it involves" could imply that all eight FCG elements are required to establish and maintain an ethical culture.

  On further reflection, the PT and BAs propose replacing that phrase with "more likely to support compliance with the fundamental principles when the firm takes appropriate steps." This ties back to the intended outcome of the proposed requirement (first sentence) and the proportionality aspect of the proposed requirement (second sentence).

  The term "more likely" is intended to reflect the FCG Working Group Report's information gathering findings that having the eight FCG elements implemented in an appropriate manner, proportionately, facilitates an ethical culture. Accordingly, the elements are intended to *guide* firms in meeting the requirement, rather than prescribe what they must do. How and when a firm implements the elements and to what extent will depend on the firm's nature and circumstances and its professional services, as further described in each of the bullets in paragraphs 300.5 A2 and in proposed paragraphs 300.5 A3 and A4.
- The number of bullets does not match the eight FCG elements. The PT and BAs propose removing the reference to the number of FCG elements since it is not essential and the bullets under the lead-in sentence clearly identify each of the elements.
- The bullets should contain more of the aspirational aspects and actionable examples that were contained in the IESBA viewpoints. There was also a question as to the criteria used in drawing from the IESBA viewpoints in drafting the bullet points. The PT and BAs note that:
  - The direction from the Board at the June 2026 meeting was to develop a single, principles-based, overarching requirement and targeted application material in the Code, accompanied by practical non-authoritative material (NAM) and other materials to support implementation of the framework. These bullets, therefore, aim to clearly and concisely describe, at a principles level, the essence of each of the FCG elements.
  - The criteria used for identifying the key principles from the IESBA viewpoints were initially evaluated in the FCG Potential Enduring Principles paper from the June 2026 meeting. Subsequently, those enduring principles have been further considered in developing the principles-based descriptions of the elements, reflecting the direction from the IESBA's June 2026 decision.
  - The PT and BAs expect that the NAM will provide greater opportunity to discuss the aspirational aspects and actionable examples of each element, leveraging the IESBA

viewpoints.

First bullet – Ethical leadership

The PT and BAs propose replacing "embodying" with "demonstrating" to respond to comments at the September board meeting that words such as "embody" may be difficult to translate into other languages.

The PT and BAs also propose replacing "comply with the fundamental principles" with "act ethically" since the revised proposed lead-in already includes reference to compliance with the fundamental principles.

The PT and BAs also considered the feedback from IESBA members that this bullet may be read as something that firm leadership is requiring from personnel, versus something for which leaders themselves are also answerable. The PT and BAs note that the concept that leaders are answerable is captured in this bullet ("firm's leadership … and every leader …"), as well as the bullet on accountability (as the use of personnel includes leaders) and the provision on ultimate responsibility (the ultimate responsibility lies with firm leadership).

Second bullet – Oversight and governance arrangements

The PT and BAs propose replacing "adherence to the Code" with "the ethical culture throughout the firm" to align with the subject matter of the proposed requirement, which is to establish and maintain an ethical culture throughout the firm.

The PT and BAs also note that effective monitoring is key to oversight and governance and hence included that qualifier in the sentence.

Based on the feedback received from stakeholders during Q4 outreach, the PT and BAs also propose adding "conduct," so the embedding of ethics is also included in conduct, not only in decision-making.

The PT and BAs also considered the feedback from IESBA members that this bullet may be read as firm leadership is overseeing arrangements for personnel, but not for themselves. The PT and BAs note that the language in the provision does not exclude leadership, as the language implies that the arrangements are for all personnel – and the use of the term "personnel" is intended to include leaders.

Third bullet – Independent input

Based on IESBA members' input at the September 2026 meeting, the PT and BAs propose adding "other sources" to clarify that sources of independent input may include sources other than individuals, such as organizations.

The PT and BAs also considered feedback from the September 2026 meeting around the threshold that triggers consideration of obtaining input. This included suggestions such as removing "matters involving the public interest" and more clearly defining what the threshold is with regards to decisions, for example, whether tendering for an audit engagement is a strategic decision. The PT and BAs note that:

- The bullet is drafted intentionally to incorporate an element of proportionality, as different firms could benefit from independent input on different topics depending on their specific facts and circumstances.
- An example of incorporating proportionality is narrowing the matters to "significant strategic, governance and business" topics that meet a specific threshold of "involving the public interest."

- A tender for an audit may be a strategic decision if the firm does not typically conduct audits in the given industry or jurisdiction. Therefore, it will depend on the firm's facts and circumstances.

The PT and BAs also note that this bullet provides for the firm to use its judgment and discretion as to whether independent input is sought based on its facts and circumstances in a given situation. This was also a concept noted in the IESBA viewpoints ("Not all situations need or benefit from independent input.").[3] Proportionality in terms of how to do it is further explained in proposed paragraphs 300.5 A3 and A4.

Fourth bullet – Accountability across the firm

The PT and BAs propose replacing "to act in accordance with the fundamental principles" with "to act ethically" as explained above.

Fifth bullet – Incentives and disincentives

Based on the input from IESBA members at the September 2026 meeting, the PT and BAs propose to combine the bullets on Incentives and Disincentives by including them as sub-bullets under the bullet "Incentives and disincentives." The PT and BAs propose this sub-bullet configuration, instead of combining the two bullets into one bullet, to make clear which sentence is referring to which aspect of the element, and to maintain consistency with the other bullets.

Additionally, based on further input from IESBA members at the September 2026 meeting, other proposed changes include:

- To replace "consider" with "reinforce," to clarify that incentives should reinforce ethical behavior.
- To add "communications" as one of the actions to deter and respond to unethical behavior.

The PT and BAs also considered feedback from the September 2026 meeting that the focus of the Incentives sub-bullet should be on encouraging personnel to act ethically, rather than on incentives that motivate personnel to act unethically. The PT and BAs note that:

- The phrase "…that reinforce ethical behavior alongside financial targets" is to encourage personnel to act ethically.
- The phrase "…and do not motivate personnel to act unethically" is to clearly address the pressures that performance evaluations and compensation practices can create, intentionally or unintentionally, for personnel to compromise ethical behavior.

The PT and BAs also considered feedback that the sub-bullet on Incentives should include promotion decisions. The PT and BAs note that promotion is implicit in the provision, as it is a part of performance evaluation and compensation practices, and can be further explained in NAM.

Sixth bullet – Open discussion and challenge

The PT and BAs acknowledge the feedback from IESBA members that leadership has a key role in fostering an environment of open discussion and challenge. The PT and BAs also note that all personnel (including leadership) contribute to that environment through their behavior and interactions. As the lead-in refers to the firm, it is for the firm to allocate specific responsibilities within its leadership for fostering

[3] See the IESBA viewpoints, paragraph C4.

that environment. Further, proposed paragraph 300.5 A1 explains that ultimate responsibility rests with the firm's leadership. The role of leadership in fostering an environment of open discussion and challenge can be further explained in NAM.

Seventh bullet – Education and training

Based on IESBA members' input at the September 2026 meeting, the PT and BAs propose to add "regularly" to emphasize the ongoing nature of education and training. Further, the concept of regular education and training also implies that such education and training will be current. The PT notes that the term "regularly" is also used in the Code in reference to training.[4]

Based on stakeholder feedback during Q4 outreach, the PT and BAs also propose adding "professional judgment" to incorporate the concept that education and training should also help develop personnel's professional judgment in identifying and addressing ethical dilemmas, in addition to an ethical mindset.

Eighth bullet – Transparency

For the same reasons stated above in Incentives and Disincentives, the PT and BAs propose to combine the bullets on Internal Transparency and External Transparency by including them as sub-bullets under the bullet "Transparency."

Additionally, based on IESBA members' input at the September 2026 meeting, the PT and BAs propose to add "as appropriate" to incorporate the firm's consideration of confidentiality when sharing ethics-related learnings and experiences within the firm.

Further, the PT and BAs propose to remove "the importance of" so that the sub-bullet on Internal Transparency incorporates the reinforcement of ethical behavior more broadly. For example, sharing ethics-related learnings and experiences could also reinforce the *understanding* of ethical behavior, not only the *importance* of ethical behavior. The various ways that ethical behavior is reinforced can be further explained in NAM.

The PT and BAs considered IESBA members' feedback that this sub-bullet should also include leaders' responsibility to be transparent in their own decision-making and actions. The PT and BAs note that this sub-bullet purposefully does not mention who in the firm is responsible, as all individuals in the firm can share ethics-related learnings and experiences, for instance at a team meeting. This sub-bullet therefore does not preclude leadership.

Proposed paragraph 300.5 A3 – Proportionality considerations

Key IESBA members' comments from the September 2026 meeting and the PT and BAs' responses are as follows:

- To remove the reference to "steps" given that it was not mentioned in the September proposed requirement.

  The PT and BAs propose to retain this reference, as "appropriate steps" is now included in the proposed requirement. As mentioned above, "steps" caters to proportionality and scalability as it recognizes that (different) firms might take different steps in relation to the FCG elements

[4] E.g., paragraph 200.7 A4: "… Training that is provided regularly to all relevant employees so they obtain and maintain the professional competence …"

mentioned in the previous paragraph in order to establish and maintain an ethical culture.

- To clarify the last sentence of the lead-in by adding "might" so that makes it clearer that the factors (bullets) mentioned underneath are not an exhaustive list.[5] This has been incorporated in the proposed changes.
- To consider whether there are any additional factors specific to FCG – other than potential implications relating to the firm being part of a network, which is mentioned in the last bullet. The PT and BAs note that this is not intended to be an exhaustive list.
- To clarify the last bullet on network firms, as it was not clear what firms need to consider.

  The PT and BAs note that all bullets – including this one – are meant to apply to an entity that is scoped in under the Code's definition of a "firm." This means that this bullet can be read from the perspective of (1) a local firm – e.g., network-wide policies issued by the global firm might be relevant when a local firm establishes and maintains its ethical culture; and (2) the global firm – e.g., events that occurred at a local level might be relevant when the global firm establishes and maintains its ethical culture, because those events might have a reputational impact and/or warrant changes to network-wide policies. The PT and BAs note there will be the opportunity to elaborate on this further through NAM.

Proposed paragraph 300.5 A4 – Proportionality considerations

The changes proposed to this paragraph are to enhance clarity and to align with the wording used in the second sentence of the proposed requirement.

~~**GLOSSARY**~~

~~Personnel~~	~~Partners and staff in the firm.~~
~~*(Professional Accountants in Public Practice)*~~	
~~Staff~~	~~Professionals, other than partners, including any experts the firm employs.~~
~~*(Professional Accountants in Public Practice)*~~	

At the September 2026 meeting, an IESBA member flagged that there could be potential unintended consequences of adding a definition for the term "personnel," even if such a definition is aligned with the

[5] "*Relevant factors to consider might include:*" is used e.g. in paragraphs 250.9 A3 and 340.9 A3 of the extant Code; and a similar variation is used in paragraph 600.13 A1 of the extant Code.

definition of the same term in ISQM 1. For example, adopting the same definition of "personnel" as in ISQM 1 without the related application material (paragraphs A20 and A21) could lead to ambiguity as to whether an engagement quality reviewer would be scoped in under the long association provisions in Section 540 of the Code if this individual is not a member of the firm but is engaged externally.

Therefore, the PT and BAs propose retaining the term "personnel" in the FCG provisions but without defining it, leaving its application to be principles-based as is the case with the various references to "personnel" across the extant Code. The PT and BAs note that "personnel" is intended to include a firm's leadership.