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Dear Mr Siong,

Exposure Draft – Proposed Revisions to the Code to Promote the Role and Mindset Expected of Professional Accountants

The Financial Reporting Council (FRC) welcomes the opportunity to comment on this exposure draft. As the UK's Competent Authority for Audit, our mandate includes: the setting of auditing, assurance and ethical standards; inspection of public interest entity audits and enforcement action against auditors. We also oversee the accountancy profession in regulation of its members and take public interest misconduct cases where conduct falls below expected standards (e.g. where practitioners fail to comply with the fundamental principles and requirements set out in the Code of Ethics). The FRC also is responsible for setting the UK Corporate Governance Code and its associated guidance.

We strongly support the aim of IESBA to enhance the role, mindset and behavioural characteristics expected of all professional accountants when performing their professional activities. Insufficient scepticism, particularly among auditors, is a continuing concern and has been raised in many of our public reports on audit quality. As we commented in our response to the scepticism consultation in July last year, parliamentary committee enquiries into high profile corporate failures in the UK have raised issues not just about auditors, but also the need for preparers to be prepared to respond to high expectations when preparing information for users. We also commented in that response that a lot is already known about what is needed to best meet the expectations of users, namely: high quality, robust and reliable financial information to use for making decisions on capital allocation and investment, and for demonstrating financial stability and regulatory compliance in the public interest. This requires the consistent application of both technical skills and behavioural competencies and there should be focus on that.

Given the importance of these concerns, we believe IESBA could go further in strengthening the requirements and related application material it is proposing. We identify specific issues and suggested actions below in our responses to the questions asked in the Exposure Draft, including:

- Section 100 should highlight that complying with the Code and acting in the public interest requires an appropriate mindset and give examples of the key characteristics and behaviours that are required to do this (see Q1).
- Accountants should always act appropriately when confronting dilemmas or difficult

situations, rather than just having the "determination" to act appropriately (see Q2).

- The concept of an inquiring mind is a positive step; however, it should include more emphasis on the need for accountants to be satisfied with the integrity, relevance and sufficiency of information they are using, or are otherwise associated with. This could be achieved by requiring all professional accountants to act with professional scepticism, which would avoid the need to introduce a 'new', overlapping, concept. However, the most important consideration is to focus on the actions, characteristics and behaviours are required of a professional accountant rather than what a suitable covering term might be and, therefore, we accept the introduction of the concept of an inquiring mind (see Q5).
- In addition to being "aware of the risk of bias", it should be expected that accountants will actually "avoid" conscious bias and seek to avoid unconscious bias (see Q6).
- With regard to promoting an appropriate organisational culture, for firms that undertake audits, reviews, other assurance and related engagements, it would be better to have a requirement within the Code itself rather than a cross reference to ISQM 1, as that standard may not be adopted in all jurisdictions (see Q7).

We also urge IESBA to give consideration to how the actions, characteristics and behaviours of professional accountants can be clearly and unambiguously evidenced so that regulators, including professional bodies and independent audit regulators like the FRC, can satisfy themselves that ethical and behavioural considerations have been at the forefront of the mind, and have driven the actions and work of those individuals.

Responses to request for specific comments

Role and Values of Professional Accountants

1. Do you support the proposals in Section 100 that explain the role and values of professional accountants as well as the relationship between compliance with the Code and professional accountants acting in the public interest? Are there other relevant matters that should be highlighted in these paragraphs?

The primary objective, of the proposals are to promote the role and mindset expected of professional accountants, but the material in Section 100 does relatively little in this regard. Section 100 should highlight that complying with the Code and acting in the public interest requires an appropriate mindset and give examples of the key characteristics and behaviours required. This could be done by expanding the list in 100.1.A2 to include, for example:

- Understanding the needs of users of information, the accountant is associated with.
- Having an inquiring mind.
- Applying appropriate professional scepticism.
- Acting appropriately in difficult situations.

We comment further on the concepts of an inquiring mind and applying appropriate professional scepticism in our response to Q5.

We also recommend the following editorial changes:

100.1.A1 – The statement that "Compliance with the Code **enables** accountants to meet their responsibility to act in the public interest ..." could be taken to imply that compliance with requirements set out in the Code is all that is needed to achieve this. It is likely that accountants will face particular circumstances which require them to go further. We recommend that "enables" is changed to a term such as "supports" or "assists".

It would be helpful, particularly for PAIBs, if further guidance was added to help explain the statement "A professional accountant's responsibility is not exclusively to satisfy the preferences or requirements of an individual client or employing organisation ...". For example, identifying that a professional accountant acting in the public interest also has regard to the needs of users of information the accountant is associated with.

100.1.A2 – The statement in the last sentence should be strengthened by changing "might" to "can" regarding intended users' reliance on the advice or other output of the accountant.

100.1.A3 – The Code sets out principles and requirements that establish expected standards of behaviour. However, only Part 4 (addressing independence for audit, review and other assurance engagements) specifically sets out "standards". Accordingly, we recommend that in this paragraph "ethics standards" is changed to "ethical standards of behaviour".

Determination to Act Appropriately

2. Do you support the inclusion of the concept of determination to act appropriately in difficult situations and its position in Subsection 111?

This should be expressed more strongly in 111.1.A2 as "acting appropriately when confronting dilemmas or difficult situations", rather than just having the "determination" to act appropriately.

Professional Behaviour

3. Do you support the proposal to require a professional accountant to behave in a manner that is consistent with the profession's responsibility to act in the public interest in paragraphs 110.1 A1 (e) and R115.1?

Yes.

Impact of Technology

4. Notwithstanding that the IESBA has a separate Working Group that is exploring the implications of developments in technology, are there any additional matters relating to the impact of technology beyond the proposals in paragraphs 110.1 A1(b)(iii), 113.1 A2 and 120.12 A2 that you consider should be addressed *specifically* as part of the Role and Mindset project?

No. We agree with the proposed references that serve to identify the need to be aware of technology-related developments and possible related issues. We have not, at this time, encountered specific ethical issues related to technology that could not be addressed at a high level by the extant ethical principles. However, we recognise that these are developing areas and support the working group further exploring the implications of developments in technology. The challenges that may be created by developments are not uniquely concerned with ethics and there is likely to be considerable overlap of interests between IESBA, IAASB and IAESB and we encourage co-operation in this respect.

Inquiring Mind

5. Do you agree with the concept of an inquiring mind as set out in the proposals in Section 120?

Professional accountants should be satisfied with the integrity, relevance and sufficiency of

information they are using, or are otherwise associated with, and, should be inquisitive about the information and conduct such assessment or investigation as may be appropriate in the circumstances. This requires the characteristics and behaviours expected of auditors and other assurance providers in applying appropriate professional scepticism. We believe that the concept of professional scepticism should apply more generally to all professional accountants, avoiding the need to introduce a 'new', overlapping, concept. Indeed, there is nothing in the definition of professional scepticism that restricts it to audit and other assurance services or that would preclude its application more generally, other than IESBA agreeing that the term 'professional scepticism' should be reserved for use only in an audit or assurance context.

We believe that 'professional scepticism' could be applied more widely, with application material to address what might be 'appropriate' in different circumstances. The most important consideration is to focus on the actions, characteristics and behaviours required of a professional accountant rather than what a suitable covering term might be. Therefore, on balance, we accept the introduction of the concept of an inquiring mind. However, paragraph 120.5.A3 which leads into the explanation of the concept should be stronger than just saying "An understanding of known facts and circumstances is a prerequisite to the proper application of the conceptual framework". There should also be emphasis on the need to be satisfied with the integrity, relevance and sufficiency of information an accountant is using or are associated with.

There is a significant overlap between the concepts of an inquiring mind and professional scepticism which may lead to questions about the expected behaviours in different circumstances. The Explanatory Memorandum suggests that paragraph 120.5.A5 highlights the differences in scope between 'having an inquiring mind' and 'exercising professional scepticism'. However, we believe that paragraph 120.5.A5 just identifies that all professional accountants are required to have an inquiring mind and that, additionally, accountants performing audits, reviews and other assurance engagements are required to exercise professional scepticism as described in paragraphs 120.16.A1 and 120.16.A2. This does not highlight differences in scope but suggests that professional scepticism is something beyond an inquiring mind. Paragraphs 120.16.A1 and 120.16.A2 also do not clearly identify differences in scope but, focus on explaining how compliance with the fundamental principles supports the exercise of professional scepticism.

We recommend that paragraph A120.5.A5 be revised to make clear that there is an overlap in the concepts of an inquiring mind and professional scepticism and not that professional scepticism is something completely separate. Paragraph A.16.A1 should also be amended to refer back to the concept of an inquiring mind.

With regard to the other specific proposed application material for an inquiring mind, we recommend that:

A120.5.A3(b) – be strengthened to say "critically evaluate the information obtained where appropriate, having regard to ..." rather than say "consider" whether there is a need to critically evaluate. Going on to take action where appropriate may be taken to be implied by the term "consider" but it is better to be more explicit, particularly from a regulatory perspective.

It should also be made clear that a critical evaluation should consider the information from a qualitative as well as quantitative aspect.

120.5.A4 – be expanded to "consider whether other relevant information might reasonably be available and, if so, whether it should be obtained and used". This is not intended to imply an extensive search.

Bias

6. Do you support the approach to addressing bias? If so, do you agree with the list of examples of bias set out in paragraph 120.12.A2? Should any examples be omitted, or new ones added?

This needs to be strengthened. In addition to being "aware of the risk of bias", an accountant should "avoid" conscious bias and seek to avoid unconscious bias. However, it should also be made clear that bias is not an issue when it is in effect a requirement in the development of certain information and that is made clear to the users of the information. For example, the accountant may be required to apply the concept of 'prudence' in making assumptions rather than be neutral.

We are generally supportive of the list of examples. However, they need to be described as examples of "possible" bias and the text should recognise that the actions described may not be appropriate in some circumstances. For example, using an initial piece of information as an anchor may be appropriate only where the accountant has good reason to believe in the veracity of that information.

The risk of bias is a threat to compliance with the fundamental principles. Accordingly, it should be addressed in the sub-sections on identifying and addressing threats, rather than in a separate sub-section on "other considerations when applying the conceptual framework".

Organisational Culture

7. Are there any other aspects about organisational culture in addition to the role of leadership that you consider should be addressed in the proposals?

Ethical values may vary between organisations, particularly where there are no applicable regulations or codes intended to drive an ethical culture. We recommend, therefore, that the application material be expanded to direct professional accountants, no matter what their position in the organisation, to seek to promote an appropriate ethical culture. Accountants can do this by complying with the Code, but also seeking to encourage other persons, to whom the Code may not apply, to both promote and apply appropriate ethical values.

For firms that undertake audits, reviews, other assurance and related engagements, it would be better to have a requirement within the Code itself rather than a cross reference to ISQM 1, as that standard may not be adopted in all jurisdictions. Such a requirement could be along the lines of:

"The senior management of the firm and those with direct responsibility for the management of the firm's audit, review, other assurance and related business shall instil the necessary culture and behaviours respectively throughout the firm and that business, so as to ensure that meeting the fundamental principles and other provisions set out in the Code is paramount and overrides all commercial interests of the firm."

There could also be further related requirements to establish appropriate policies, procedures and quality management systems.

If you have any questions on our response, or wish to discuss any of our observations in more detail please contact Mark Babington, Acting Director, UK Auditing Standards and Competition, Financial Reporting Council on m.babington@frc.org.uk or +44-20-7492-2323.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Stephen Haddrill', with a horizontal line underneath.

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