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Dear Mr Siong,

Exposure Draft – Proposed Revisions to the Code Pertaining to the Offering and Accepting of Inducements

The Financial Reporting Council (FRC) welcomes the opportunity to comment on the proposed changes to the Code of Ethics for Professional Accountants (the Code) set out in the exposure draft referred to above.

The FRC supports the Board's objective to strengthen the provisions in Part C of the Code to assist professional accountants in business (PAIBs) and professional accountants in public practice (PAPPs) in better dealing with the offering and accepting of inducements while complying with the Code's fundamental principles. From an ethical perspective, the threats to compliance with the fundamental principles that arise from the offering or accepting of inducements are essentially the same for all professional accountants and, accordingly, we agree that the enhancements to the provisions in Part C should also be applicable to professional accountants in public practice (PAPPs).

We agree that:

- there are no safeguards that can reduce threats created by inducements with improper intent (including those that are trivial and inconsequential) to an acceptable level; and
- threats should be evaluated "through the reasonable and informed third party lens".

However, we believe the requirements and application material could be enhanced and clarified, including:

- Introducing a specific requirement in relation to circumstances where inducements are made with no intent to improperly influence behaviour (see response to Q1).
- Extending the requirements in Sections 420 and 906 to cover offering gifts and hospitality; and for the considerations in these Sections to also be made through the reasonable and informed third party lens (see response to Q3).

We explain these, and other points, more fully below.

Responses to Requests for Specific Comments

Proposed Section 250

1. *Do respondents support the proposals in Section 250? In particular, do respondents support the proposed guidance to determine whether there is an intent to improperly influence behaviour, and how it is articulated in the proposals?*

Inducements with intent to improperly influence behaviour

An inducement made to a recipient other than the professional accountant (e.g. to a close relative) could be made with the intent of influencing the behaviour of the professional accountant as well as, or instead of, the actual recipient. The proposed requirement in paragraph R250.8 should be clarified as follows:

“A professional accountant shall not accept, or encourage others to accept, any inducement that the accountant has reason to believe is made, or that believes a reasonable and informed third party would be likely to conclude is made, with the intent to improperly influence the recipient’s behaviour of the professional accountant or other recipient.”

The supporting guidance (in paragraph 250.9 A1) identifies some factors to consider in determining whether there is actual or perceived intent to improperly influence behaviour. The same list of factors is also cross referred to later as being relevant in evaluating the level of any threats created by offering or accepting an inducement with no intent to improperly influence behaviour. The general guidance given in paragraph 250.4.A1 states that: “An inducement is an object, situation, or action that is used as a means to influence another individual’s behavior, but not necessarily with the intent to improperly influence that individual’s behavior. ...” It would be helpful if some guidance was added to help clarify what is “intent to improperly influence” behaviour. Having regard to the discussion in the Explanatory Memorandum, this could be where the intent is to cause the professional accountant to be “unethical”, for example, where the inducement is intended to cause the professional accountant to breach one or more of the fundamental principles.

Inducements with no intent to improperly influence behaviour

There are no specific requirements in this section; instead there is just guidance in paragraph 250.10 A1 that “Unless an inducement is trivial and inconsequential, the requirements and application material set out in the conceptual framework apply when a professional accountant believes there is no actual or perceived intent to improperly influence behavior.” As there are no references to inducements in the conceptual framework, we believe it would be helpful to include a specific requirement as follows before paragraph 250.10 A1:

“A professional accountant shall not offer or accept, or encourage others to offer or accept, an inducement in relation to which the professional accountant believes there is no actual or perceived intent to improperly influence behaviour, unless a reasonable and informed third party would be likely to conclude the inducement is trivial and inconsequential.”

In the Explanatory Memorandum, IESBA identifies that one way threats can be addressed is if the professional accountant simply does not offer or accept the inducement. However, it explains that it does not believe there is a need to explicitly state this in the Code "as this option is always available to the professional accountant, consistent with eliminating the circumstances creating the threats under the conceptual framework." We believe this way of addressing a threat should be stated explicitly in the Code to emphasise that option.

Proposed Section 340

2. *Do respondents agree that the proposed provisions relating to inducements for PAPPs should be aligned with the enhanced provisions for PAIBs in proposed Section 250? If so, do respondents agree that the proposals in Section 340 achieve this objective?*

Yes, for the reason given above, we agree that the proposed provisions relating to inducements for PAPPs should be aligned with the enhanced provisions for PAIBs in proposed Section 250. The changes we propose above in relation to Section 250 should also be made to the corresponding paragraphs in Section 340.

Proposed Conforming Amendments to Independence Provisions

3. *Do respondents support the restructuring changes and proposed conforming amendments in proposed Sections 420 and 906?*

We have commented on, and set out significant concerns in relation to the proposed changes to the structure of the Code in our responses to the Structure EDs. Our response here covers only the proposed conforming amendments.

Even where not intended to be an inducement, actual or perceived familiarity threats can arise if gifts or hospitality are offered to an audit client. Accordingly, in these Sections the requirements should be extended to also prohibit the firm, network firm or audit team member from offering gifts and hospitality to an audit client unless the value is trivial or inconsequential. Further, consistent with the approach to inducements, the consideration should be made through the reasonable and informed third party lens. A suggested rewording of paragraph R420.4 is:

"In addition to complying with the requirements relating to the offering or accepting of inducements set out in Section 340, a firm, network firm or audit team member shall not offer or accept gifts and hospitality from in relation to an audit client, unless a reasonable and informed third party would be likely to conclude the value is trivial and inconsequential."

Conforming changes should also be made to paragraphs 420.2 and 420.3 to cover offering gifts and hospitality.

Paragraphs R906.4, 906.2 and 906.3, which apply to other assurance engagements, should be amended in the same way.

4. *Do respondents believe the IESBA should consider a project in the future to achieve further alignment of Sections 402 and 906 with proposed Section 340? If so, please explain why.*

Subject to reflecting the amendments we propose in our response to question 3, we do not believe that a project is necessary to further align Sections 402 and 906 with proposed Section 340. Section 340 covers inducements, including where they take the form of gifts and hospitality. However, not all gifts and hospitality will necessarily be intended to be inducements to influence behaviour, they may for example be simply a "thank you". Nonetheless, such gifts and hospitality can still give rise to threats or perceived threats to independence and it is appropriate that they are also considered in this context as is in effect done in Sections 402 and 906.

If you have any questions on our response, or wish to discuss any of our observations in more detail please contact Mark Babington, Deputy Director of Audit Policy on m.babington@frc.org.uk or +44-20-7492-2323.

Yours sincerely,



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