FIRM CULTURE AND GOVERNANCE

IESBA International Ethics Standards Board for Accountants®

IESBA FIRM CULTURE AND GOVERNANCE WORKING GROUP FINAL REPORT

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International
Ethics Standards
Board for Accountants®

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The Firm Culture and Governance Working Group would like to express its sincere gratitude to all stakeholders who participated in outreach activities throughout 2024 for their invaluable insights and contributions.

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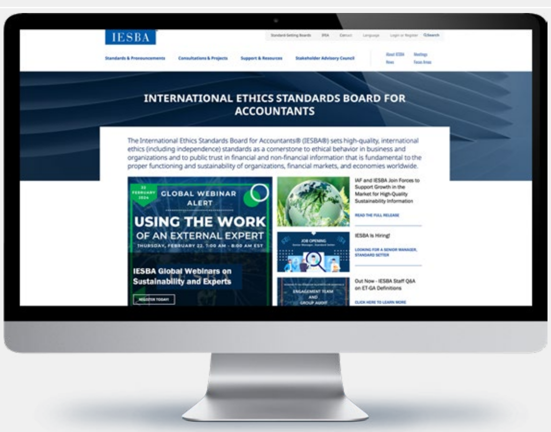


About the IESBA

The International Ethics Standards Board for Accountants (IESBA) serves the public interest by setting high-quality ethics standards, including independence requirements, as a cornerstone to ethical behavior in business and organizations, and to public trust in financial and non-financial information that is fundamental to the proper functioning and sustainability of organizations, financial markets and economies worldwide.

Along with the International Auditing and Assurance Standards Board (IAASB), the IESBA is part of the International Foundation for Ethics and Audit (IFEA). The Public Interest Oversight Board (PIOB) oversees IESBA and IAASB activities and the public interest responsiveness of the standards.

I. EXECUTIVE SUMMARY

Unethical Behavior by or within Accounting Firms

1. In recent years, there have been an increasing number of high-profile cases of unethical behavior by or within accounting firms, with some recent cases in the United States, the United Kingdom, the Netherlands, South Africa and Australia, among other jurisdictions, resulting in major sanctions, multi-million-dollar penalties, and adverse publicity that have damaged the reputations of the firms involved and eroded trust in the profession.

2. These cases have led to concerns that ethical failures within firms and networks that have an important role in the jurisdictions where they operate could impact the regular functioning of capital markets, the tax system, and economies more broadly. Therefore, ethical behavior by or within these accounting firms is a public interest issue.

3. The public interest implications of unethical behavior by or within accounting firms fall within the IESBA's mandate as a global ethics standard setter. Accordingly, the IESBA established the Firm Culture and Governance Working Group (FCGWG) under its Terms of Reference to:

(a) Gather an understanding of culture and governance and their impact on compliance with ethics and independence requirements in accounting firms and, where applicable, their networks ("firms");

(b) Review the extant provisions on organizational and firm culture in the IESBA Code and consider whether the Code should be further strengthened to reinforce a robust culture of ethical behavior within firms;

(c) Raise awareness of the issues relating to, and the importance of, governance and ethical culture within firms through outreach activities; and

(d) Develop a report and recommendations to the IESBA.

The FCGWG's Research and Key Findings

4. To understand the impact of culture on ethical behavior in accounting firms and how these firms can establish an ethics-based culture to mitigate the risks of unethical behavior, the FCGWG has undertaken a significant number of in-person and virtual meetings with a broad group of stakeholders, including regulators, standard-setters, those charged with governance (TCWGs), finance executives and global and national leaders of firms and commissioned academic research. The insights and findings collected from these extensive and diversified outreach initiatives have already been subject to discussions with the IESBA Board and its leadership, as well as the Public Interest Oversight Board (PIOB) and other institutional stakeholders. This report incorporates the product of such reflections.

5. From the input the FCGWG has received, it has become clear that:

- Unethical behavior by or within accounting firms can severely damage the reputation of the firms concerned and, more broadly, the accountancy profession.
- While some instances of unethical behavior may be attributable to one or more individuals, unethical behavior has also been widespread in some of the cases, reflecting likely deficiencies in the relevant firm's ethical culture.
- A strong ethical culture, supported by ethical leadership and a governance framework at a firm-wide level that prioritizes and incentivizes ethical values, empowers firms to operate as ethical firms, mitigates the risk of unethical behavior, enhances a firm's reputation, reinforces the profession's role to act in the public interest, and builds public trust.
- While firms play a key role and have the ultimate responsibility for their ethical culture, there are other stakeholders in the ecosystem whose roles and responsibilities impact how firms nurture their ethical culture.

6. The FCGWG has identified two key influencing factors of a strong ethical culture that promote ethical behavior within firms. The first is leaders who prioritize ethical values in their strategies, decisions and communications, and who, by their conduct, exemplify those values.

7. Another key influencing factor is a culture and governance framework that embeds ethical values in a firm's oversight, governance as well as other areas and mechanisms, covering the firm's strategy and operations, from business growth to decision-making processes, impacting service lines and partners and staff across the whole organization. This includes:

- Leadership and oversight that are ultimately responsible and accountable for the firm's culture and ethical performance.
- A whole-of-firm accountability mechanism that holds all partners and staff accountable for maintaining ethical standards and upholding the firm's values.
- The provision of input by independent persons (such as independent non-executives) promoting and monitoring the firm's commitment to its ethical values and its responsibility to act in the public interest.
- Incentives and rewards aligned with the firm's ethical values.
- An environment that encourages open discussion and challenge, including a speak-up culture.
- The provision of increased education and training on ethical standards and policies throughout the careers of partners and staff of the firm.
- Transparent reporting and dialogues about the firm's ethical performance.

The FCGWG's Recommendations

8. The FCGWG recommends that the IESBA approve two new work streams to be commenced in 2025:

(a) A standard-setting project to develop provisions to address firm culture and governance, focusing on a firm's leadership and a culture and governance framework covering the firm's oversight, governance as well as related areas such as incentives and accountability mechanisms. The new provisions should be principles-based, scalable and applicable across all service lines of the firm.

(b) The development of a series of Non-Authoritative Materials (NAMs) on topics that will complement and promote the work of the standard-setting project. At the time of writing this report, the FCGWG has identified the following potential topics:

  - Importance of ethical culture in driving behavior.
  - Common characteristics of an ethical firm.
  - Contributions of stakeholders within the ecosystem in promoting ethical behavior.

II. INTRODUCTION

Background

9. The accountancy profession has been facing high-profile incidents linked to unethical behavior in accounting firms relating to both their audit and consulting services. Some recent cases involving professional accountants in public practice (PAPPs) have led to significant practice sanctions, multi-million-dollar penalties[1] and other adverse consequences for individual PAPPs and their firms in multiple jurisdictions. This is a critical challenge for the accountancy profession and for its value proposition.

10. In response to these issues, the IESBA released a public statement in July 2023 emphasizing the vital importance of ethical behavior for all professional accountants (PAs) and reminding them of their ethical obligations under the Code. These obligations include upholding the fundamental principles of the IESBA Code[2] (the Code) and complying with its specific requirements, which enable PAs to meet their responsibility to act in the public interest.[3]

11. The IESBA is of the view that the recurring unethical behavior in firms calls into question their culture and governance and how these might impact the ethical behavior of individual PAs and their compliance with the Code. As underscored in the IESBA's 2024-2027 Strategy and Work Plan (SWP), firm culture affects the reputation of individual firms and the public trust in the accountancy profession.

12. Recognizing the significant public interest implications of unethical behavior in the profession and the IESBA's responsibilities as a global ethics standard-setter, the IESBA has determined to address the topic of Firm Culture and Governance (FCG) as a strategic priority in its SWP, with a new work stream that commenced in Q1 2024.

Objectives of the Working Group

13. In December 2023, the IESBA formed a new working group to undertake the research and analysis required to achieve the objectives established by the FCGWG's Terms of Reference, [4] namely to:

(a) Gather an understanding of culture and governance and their impact on compliance with ethics and independence requirements in accounting firms and, where applicable, their networks ("firms");

(b) Review the extant provisions on organizational and firm culture in the Code and consider whether the Code should be further strengthened to reinforce a robust culture of ethical behavior within firms;

[1] For example, in the United States (US), the US SEC and PCAOB have placed sanctions on firms in relation to the examination cheating scandals that occurred between 2019 and 2024. The fines imposed ranged from $2 million to $100 million. Refer to Appendix 8 for some recent examples of scandals affecting firms where regulators have reported ethical lapses.

[2] International Code of Ethics for Professional Accountants (including International Independence Standards)

[3] The Global Accounting Alliance (GAA), representing an alliance of professional accounting organizations (PAOs), also highlighted the profession's responsibility to act in the public interest despite increasing pressures on PAs to act unethically, thereby reinforcing the Code's importance (August 2023).

[4] Refer to the FCGWG's approved Terms of Reference.

(c) Raise awareness of the issues relating to and the importance of governance and ethical culture within firms through outreach activities; and

(d) Develop a report and recommendations to the IESBA.

Approach

14. As part of its information gathering, the FCGWG:

- Conducted an extensive outreach program throughout 2024[5] that included a series of stakeholder meetings and interviews, both in person and virtually, allowing for engagement with a wide range of stakeholders.
- Commissioned an academic to prepare a report that synthesizes findings from academic literature on the topic of culture and ethical behavior in organizations.
- Examined existing frameworks, including two jurisdictional audit firm governance codes and the International Standard on Quality Management 1 (ISQM 1).[6] As part of this examination, the FCGWG also held discussions with representatives from the United Kingdom Financial Reporting Council (UK FRC), Japan Financial Services Agency (JFSA), and IAASB to understand these frameworks further.[7]
- Undertook additional literature reviews and other desktop research (See Appendix Six).

15. In reaching its findings (Section IV), the FCGWG considered the information received from its information-gathering activities, input received from the Board and the PIOB, and its analysis of the Code's existing provisions on the topic.

16. To develop its recommendations (Section V), the FCGWG has taken into account the IESBA's primary role as a global standard-setter, its strategic priorities, and its public interest mandate.

Format of the Report

17. The report is structured as follows:

- Section III summarizes the FCGWG's information gathering and review. Further details are included in Appendices One to Five.
- Section IV presents the FCGWG's findings, which include the public interest issues, and sets the stage for understanding the context and rationale behind the Working Group's recommendations.
- Section V outlines the FCGWG's recommendations and proposed timeline.

[5] Refer to Appendix Seven for the list of stakeholders consulted.

[6] International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*.

[7] The FCGWG examined two existing Audit Firm Governance Codes (see Appendix Four) and the IAASB's ISQM 1 (see Appendix Five).

III. INFORMATION GATHERING AND REVIEW

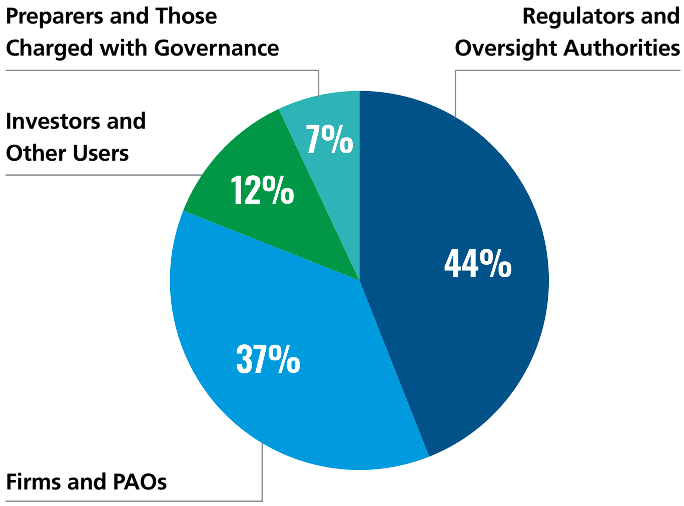
Stakeholder Outreach Feedback

18. The FCGWG conducted an extensive outreach program throughout 2024,[8] which facilitated a broad engagement with various global and jurisdictional stakeholder groups, including regulators, firms (and, in certain instances, their INEs), professional accountancy organizations (PAOs), finance executives, investors and those charged with governance communities.

19. Between Q1 and Q4 2024, members of the FCGWG held over 50 virtual and in-person meetings in Toronto, Tokyo, Singapore, New York, Sydney, Melbourne, and London, meeting with a diverse group of stakeholders (Refer to Appendix Seven for a list of the stakeholders).

20. Of the stakeholders consulted:

- **44%** were regulators and oversight authorities, such as the Committee of European Auditing Oversight Bodies (CEAOB), the United States Securities and Exchange Commission (US SEC), and the Japan Financial Services Agency (JFSA).
- **37%** were with firms and PAOs, representing both larger networks and small and medium practices (SMPs).
- **12%** were with investors and other users, including key organizations such as the International Corporate Governance Network (ICGN).
- **7%** were preparers and those charged with governance, such as the Institute of Directors Kenya (IoD Kenya).



Feedback was also sought at the Stakeholder Advisory Council (SAC)[9] and National Standard Setters (NSS)[10] meetings held in Q2 and Q4 2024.

[8] Refer to Appendix Seven for the list of stakeholders consulted.

[9] The Stakeholder Advisory Council (SAC) provides strategic input and recommendations to the International Auditing and Assurance Standards Board (IAASB) and IESBA. It is a forum for the IAASB and IESBA to engage with a diverse range of their external stakeholders, thereby drawing on additional expertise and experience for their standard-setting projects.

[10] IESBA hosts a meeting of a group of national standard setters from around the world that share the common goals of promulgating high-quality ethics and independence standards and reaching consensus at an early stage in their development, biannually. Currently, the meeting participants are from: Australia, Canada, China, France, Germany, Hong Kong SAR, India, Japan, the Netherlands, New Zealand, South Africa, the United Kingdom and the United States.

21. These interactions offered insights into the multifaceted nature of culture and governance framework within firms. Despite the diverse regional contexts, common themes emerged consistently across jurisdictions. Appendix One delves into these themes as shared by stakeholders in greater detail.

22. The FCGWG also gathered views on the recent trends relating to the growth in consulting services in accounting firms as well as private equity investment in accounting firms. (See Appendix One)

23. While the FCGWG received a broad range of input from stakeholders, it is anticipated that further engagement with stakeholders will occur if and when the workstream moves into the standard-setting phase as recommended by the Working Group. (See Section V.)

Academic Research

24. As part of its information gathering, the FCGWG engaged Dr. Eva Tsahuridu to prepare a report[11] on organizational culture by synthesizing findings from global academic literature on the topic of culture and governance (Academic Report). The report examined how important organizational ethical culture is in shaping ethical behavior within firms.

25. The academic literature highlighted in the Academic Report demonstrates that:

- The ethical culture of an organization cannot be assessed by only the policies or promotional material of an organization.
- The ethical culture of an organization has a significant impact on the ethical behavior of those within the organization, and
- Leadership and a framework of formal and informal systems, such as executive leadership, performance management systems, and decision-making processes, are two key influencing factors of an organization's ethical culture.

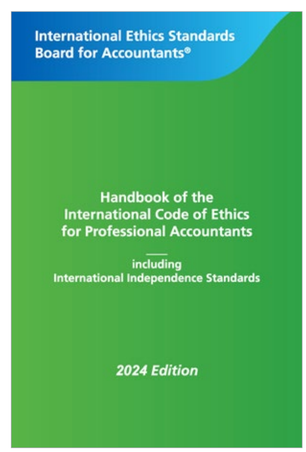
26. Dr. Tsahuridu's analysis and findings are further summarized in Appendix Two.

The Extant Code

27. The extant Code contains several provisions that relate to firm culture and governance:

- Sections 100 and 115 emphasize the profession's responsibility to act in the public interest.
- Sections 120, 200, and 300 highlight the importance of upholding and maintaining the ethical conduct expected of PAs and an ethical culture within firms. They also highlight the impact of ethical culture on the ethical behaviors of PAs and the role of leadership.

28. These provisions outline the responsibilities and expectations placed on PAs and firm leadership in upholding the public interest and promoting an ethical culture within an organization. See Appendix Three for more details.



Jurisdictional Audit Firm Governance Codes

29. As part of its consideration of other regulatory and standard-setting frameworks that address firm culture and governance, the FCGWG reviewed the audit firm governance codes issued by regulators in the United Kingdom (UK) and Japan. These codes apply to the leadership and governance structure of the whole firm and focus on promoting audit quality.

[11] Refer to Agenda item 2B – Academic Report by Dr. Eva Tsahuridu of the June 2024 IESBA Meeting.

30. A key common feature among these codes is their focus on public interest and the firm's role in serving the public interest. These codes also stress the importance of:

- Leadership and governance that promote long-term sustainability as well as the importance of setting the right environment and culture.
- Having independent input into the firm's governance structure to challenge the decision-making of the firms and to help them meet their public interest responsibilities.
- Transparency and dialogues with regulators and stakeholders.

31. See Appendix Four for more details.

International Standard on Quality Management (ISQM 1)

32. ISQM 1 addresses a firm's responsibilities in designing, implementing, and operating a system of quality management (SOQM) for audits or reviews of financial statements or other assurance or related services engagements. The objective of the SOQM is to provide the firm with reasonable assurance that both the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements. It also provides the firm with reasonable assurance that engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

33. SOQMs in compliance with ISQM 1 were required to be designed and implemented by December 15, 2022.

34. For ISQM 1, a SOQM is designed to address eight interconnected and iterative components, including governance and leadership and relevant ethical requirements.

35. The governance and leadership component of the SOQM establishes the quality objectives that establish the environment that supports the SOQM. Under this component, a firm must demonstrate its commitment to quality through a firm-wide culture that recognizes and reinforces the firm's role in serving the public interest through the performance of quality engagements, the importance of professional ethics, values, and attitudes, and responsibilities of the firm's personnel and the importance of quality in the firm's strategic decisions and actions.

36. ISQM 1 also discusses ethical requirements, emphasizing that firms must establish quality objectives that address their responsibilities in accordance with relevant ethical standards, including those related to independence.

37. While ISQM 1 provides guidance focused on specific engagements and quality management within audit and assurance practices, the IESBA Code addresses ethical principles that apply to the entire firm, regardless of the specific function or service line.

IV. WORKING GROUP FINDINGS

Public Interest Issues

38. Accounting firms have developed a brand that commands public trust, underpinned by a longstanding reputation for professionalism and integrity. Central to this trust is the crucial role firms play in the audit function, where they provide independent assurance on the reliability of financial statements, thereby fulfilling a vital public function in capital markets and for investors and economies more widely. In jurisdictions that require statutory audits, auditors operate under a legal and regulatory framework that defines their gatekeeper or watchdog role in the public interest, which is foundational to their legitimacy and license to operate.

39. As firms diversify their service offerings, expanding into non-assurance areas, it is recognized that their ability to leverage (and maintain) the public trust associated with their audit service offerings is intrinsically linked to the profession's responsibility to act in the public interest.

40. Although PAs generally strive to act ethically, unethical behavior with damaging consequences has become a persistent occurrence in recent times (as evidenced, for example, by recent high-profile events in Australia, the UK, the US, South Africa, and the Netherlands, among other jurisdictions). Unethical behavior can significantly tarnish the reputation of the firm involved, resulting in the delivery of poor-quality services, and have major impacts on the firm and its employees, the profession, and the public. In this regard, consulting services, including tax advisory services and services provided to government bodies or agencies, can often carry with them high levels of public interest, such as those provided on public policy-related matters or major infrastructure projects. Further, ethical failures in a firm's consulting services may impact not only public trust in that service line but also all other service offerings of the firm, including its audit services.

41. Further, where firms provide services that have banking, industry or economy-wide effects or impact public services[12] the stakes are even higher for these firms, as their actions can have broader impacts on industries and economies with significant public interest implications.

42. Therefore, ensuring that ethics is a high priority across all service lines is essential for a firm to maintain public trust and confidence in its work in the long term. Firms should recognize that adherence to the highest ethical standards across all service lines is a strategic value proposition and that this may be one of the best safeguards against reputational risks from unethical behavior and related consequences and policy options. Recognition as an ethical firm will help a firm to grow its business in a much more sustainable way.

[12] According to Jeremy Hirschhorn (Second Commissioner, Client Engagement Group at Australian Tax Office), "Once a firm gets to a particular size, it fundamentally changes how it should think about itself and how society will think about it. Our concept of 'systemically important' is a firm with industry or economy-wide effects in a local jurisdiction. Naturally, we say that public interest is much more important once you get to that because you can change how things work in your society. Being systemically important brings a greater demand for transparency and public accountability and when I look at the big firms in Australia, we see them as systemically important across four distinct markets: financial statements audits, large market tax advice, private sector consulting and government consulting. This of course may not be the case in all jurisdictions" (April 17, 2024) (https://www.linkedin.com/pulse/firm-culture-governance-jeremy-hirschhorn-hs9lc).

43. To facilitate firms operating as ethical firms and thereby mitigate the risk of ethical failure more holistically, it is essential to address not only ethical behavior at the individual level but also the broader organizational issues of ethical culture and governance frameworks, including leadership. These broader issues should be considered firm-wide, covering all service lines.

Strong Ethical Culture Drives Ethical Behavior

44. Ethical culture reflects the shared values and beliefs of those within an organization about what constitutes appropriate behavior and decisions from an ethical perspective. It is fundamental to a firm upholding its ethical values and complying with its public interest obligations. A strong ethical culture will help to deliver sustainable success to firms whose brand and public standing are synonymous with professionalism and integrity. It will also influence management and employee behavior and decision-making so that actions taken are aligned with the firm's ethical values and standards.

45. As highlighted in the Academic Report by Dr Eva Tsahuridu,[13] when a firm's culture embraces the ethical standards that all partners and staff are expected to uphold, they develop a mindset where ethics and the public interest are critical and unavoidable considerations. They will then be better equipped to navigate ethical dilemmas and make decisions that align with the firm's ethical values. Put simply, firms that have the right ethical culture are more likely to avoid ethical failures and the related reputational, legal and financial consequences.[14]

46. By embedding ethical values into the firm's culture, firms can foster a sustainable business model that prioritizes long-term success over short-term financial results, reinforcing their commitment to the public interest.

47. It is acknowledged that changing, enhancing or maintaining ethical culture demands a sustained commitment over a long period of time, as it involves reshaping attitudes, behaviors, and systems across all levels of the firm.

48. However, an ethical culture will only become embedded if a firm has:

- Leaders who prioritize ethical values and behavior as the foundation of an ethical culture and who, by their conduct, exemplify that culture, and
- A strong culture and governance framework that provides transparent procedures, oversight, and clear accountability to ensure that ethical standards and policies are implemented across all service lines of the firm.

49. When a strong ethical culture, propelled by ethical leadership, and a culture and governance framework that promotes ethical values are present, the firm's reputation, the quality of service delivery, client confidence and public trust are enhanced, and the risks arising from unethical behavior are mitigated.

Ethical Leadership with Uncompromising Commitment to Ethical Values and Public Interest

50. As highlighted in the Academic Report (See Appendix Two), ethical leadership is the most examined influencing factor of ethical culture. Leadership plays a crucial role in shaping and sustaining an ethical culture within a firm, aligning behavior with its ethical values and commitments, and setting the tone at the top for the whole firm.

51. Firm leadership must not only set the tone by communicating the importance of ethical behavior, but also lead by example, by demonstrating these values through their actions and decisions. Their behavior should consistently reflect the firm's values, serving as a model for all employees to follow.

[13] Refer to Agenda Item 2B – Academic Report by Dr. Eva Tsahuridu Of the June 2024 IESBA meeting.

[14] Refer to Appendix Eight for information on scandals involving the Big Four firms spanning from 2019 to 2024 and the repercussions of breaches in ethical conduct.

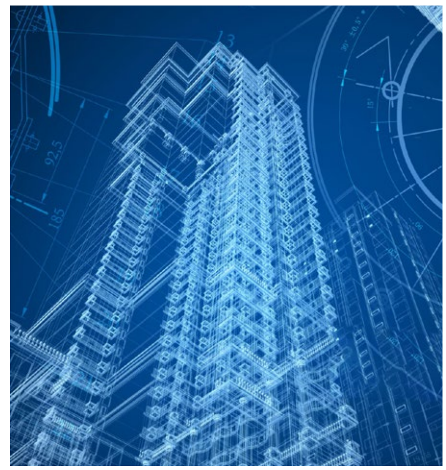
52. As highlighted in the Academic Report, what leaders pay attention to measure, and control on a regular basis, how they allocate resources, rewards and status, react to critical incidents and organizational crises as well as how they recruit, promote and dismiss, will often create and reinforce culture. How a leader responds to ethical issues will be imitated by other partners and staff in the firm.

53. Firm leadership must demonstrate their commitment to ethics and to the public interest without compromise. As a business, it is reasonable that firms invest in people, technology and make other capital investments to meet their obligations and remain profitable for its long-term sustainability. However, firm leadership must not allow commercial pressures to compromise their public interest responsibilities or their commitment to the firm's ethical values.

Culture and Governance Framework that Prioritizes Ethical Values

54. A recurring theme during FCGWG's outreach was the importance that stakeholders attributed to the existence of a culture and governance framework where all the key elements work effectively to drive the ethical culture of a firm. Such a framework includes its oversight and governance structure. It not only addresses areas such as leadership accountability, but also extends to other systems and mechanisms such as incentive and reward structures.

55. A culture and governance framework that prioritizes and incentivizes ethical values must be implemented irrespective of the firm's ownership structure and must extend to the whole firm and all service lines.



Oversight and Governance

56. The senior leadership of a firm bears the ultimate responsibility for upholding the firm's ethical values and standards and being accountable for the firm's ethical performance.

57. Ethical standards and public interest need to be key factors when senior leadership develops the firm's strategies or assesses business and financial opportunities across all service lines. In addition, they should build ethics into their business strategies as a value proposition, which in the long term may also lead to a competitive advantage for the firm.

58. Regular monitoring, evaluation, and improvement of the firm's ethical culture and performance are key responsibilities of senior leadership. In this regard, a senior leader may be allocated such responsibility as their key responsibility.

59. For global network firms, there should also be clarity between the role and responsibilities of local leadership and that of global leadership to promote consistent ethical behavior across the whole network.

The Provision of Independent Input

60. The provision of independent input to a firm from advisors, a committee of advisors or Independent Non-Executives (INEs), contributes to the effectiveness of a firm's governance framework in promoting ethical values and culture.

61. A firm should consider obtaining independent input, such as appointing person/s to provide input to its decision-making process through the lens of public interest. These advisors may provide advice on a firm's oversight over key strategies and policy matters such as the appointment of the head of a service line, how it addresses ethical issues or a firm's ethical culture. Such persons need to have the necessary skills, knowledge and experience as well as be appropriately independent. This may also be achieved through the engagement of an external advisor or consultant.

62. From the outreach and review of firms' transparency reports, it appears that firms have valued independent input in the following areas:

(a) Ethical Culture – by understanding and advising on how the firm adheres to ethical standards and complies with relevant laws and regulations. This includes advising on the firm's policies and practices to reflect its commitment to ethical values.

(b) Accountability – by holding the executive team accountable for their actions and decisions, checking whether they act in accordance with the firm's responsibility to act in the public interest, ethical standards, applicable professional standards and strategic goals.

(c) Transparency – by having access to all necessary information, discussing ethical concerns with a firm's leadership, and establishing that certain information about management's performance, such as compliance with the IESBA Code, is disclosed to the relevant stakeholders.

(d) Strategic Guidance – by bringing diverse perspectives and expertise to the table and contributing to more informed and balanced decision-making with public interest in mind.

(e) Performance Evaluation and Senior Role Appointment – by providing input in regular evaluations of the CEO (managing partner) and senior management and assessing their performance against set objectives and firm goals. INEs can also provide input in the appointment of senior teams, including the CEO (managing partner) and other leaders of service lines.

63. One important consideration in appointing an independent person/s is the size of the firm, as SMPs may not have the governance structures or resources to do so.

Accountability across the Firm

64. Accountability should extend to all partners and staff within a firm, not just its leadership. All individuals, from senior partners to entry-level staff, share responsibility for maintaining ethical standards and upholding the firm's values. Accountability mechanisms should be embedded throughout the firm so that each person, irrespective of their role, should be expected to act in accordance with the firm's ethics standards and policies.

65. Including all partners and staff in the accountability structure helps to address issues at their source rather than waiting for problems to escalate. It encourages the firm's personnel at all levels to report ethical concerns without fear, knowing that everyone is equally responsible for maintaining ethical conduct. In this way, accountability becomes a proactive measure, ensuring that issues are identified and resolved before they become more significant problems. This helps build a stronger, more resilient ethical culture that supports the firm's long-term success and public trust.

66. A number of measures that may be used to periodically assess a firm's ethical culture include partners and staff culture survey results, retention rates, training hours dedicated to ethics and culture, and client feedback.

Incentives and Rewards that Align with Ethical Behavior

67. Performance evaluations, incentives and rewards must promote a firm's commitment to ethics and integrity. As stakeholders have emphasized, such an alignment can act as a strong motivating agent for ethical behavior and is crucial for fostering an ethical culture. Performance evaluations that include metrics for ethical performance in addition to other financial and non-financial metrics send a strong signal to staff about the importance of ethical behavior.

68. For instance, when a person is promoted to a senior position within a firm, even with known poor records of ethical performance, this will impact not only staff morale but also the ethical culture of the firm. When partners and staff see that ethical behavior is recognized and rewarded, they are more likely to be motivated to give proper ethical considerations to their work and decision-making. By aligning incentives with ethical behavior, firms can create an environment where the firm's personnel are driven to act ethically.

69. Incentives and rewards extend beyond financial compensation or promotion and may include other forms of benefits such as recognition of achievement.

70. Firms must also establish strong disincentive structures for unethical behavior with clear penalties or negative consequences. How a firm's leadership responds when it discovers a breach of ethical standards or other unethical behavior will demonstrate its commitment to ethical values to not only its external stakeholders but also its other partners and staff. To act quickly, decisively, and fairly will affirm to internal and external stakeholders that leadership is prioritizing ethical behavior as a key performance measure.

The Importance of a Culture of Open Discussion and Challenge

71. A "speak-up" culture that encourages open discussion and challenge, and the identification of potentially problematic decisions or practices, is an essential element of a firm's ethical environment and, importantly, mitigates the risks of unethical behavior.

72. To achieve such a culture, firms must ensure that there are clear, accessible, and, where appropriate, confidential channels through which partners and staff of a firm can raise concerns and, if necessary, challenge decisions. They should be reassured that their concerns will be taken seriously and handled with the utmost discretion.

73. In addition, a healthy culture of open discussion and challenge also goes beyond traditional whistleblowing programs or speak-up mechanisms to voice concerns about ethical or other behavioral issues. Firms must also cultivate an environment where consultation, critical thinking and challenging the status quo are encouraged and valued. This can be achieved through regular training and communication that emphasize the importance of a culture of open discussion and challenge the firm's commitment to addressing unethical behavior and quality.

Transparency about the firm's performance

74. A firm's commitment to its ethical values and leadership accountability is evidenced by its transparency about the ethics-related aspects of the firm's performance. Such transparency should address the arrangements in place to promote the firm's ethical values, including a description of the approach taken to breaches of ethical standards and how they are addressed, as well as its ethical performance.

75. Actions such as holding open discussions with regulators about a firm's ethical performance or other ethical and public-interest-related matters may enhance transparency. Further, open and transparent dialogues by senior leadership with the firm's INEs or those in similar independent roles, as well as other relevant stakeholders such as PAOs in relation to ethics and public interest matters further strengthen the importance of ethical behavior.

76. Firm leadership being transparent to its partners and staff about how it has addressed ethical failures within the firm demonstrates the firm's commitment to ethical values and compliance with ethics standards.

Continuous Education and Training

77. Training and education play a vital role in ensuring that all members of a firm, PAs and non-PAs alike, irrespective of service lines, understand the importance of ethics and apply the firm's ethical standards and policies effectively in their professional activities.

78. Robust education and training on a continuous basis are required to ensure that employees continue to be aware of and adhere to ethical standards. Employees need to be trained not just to understand ethical rules but also to develop the necessary judgment to identify ethical issues in their professional activities. For instance, junior staff may be given the opportunities to build their ethical "muscle" and help them strengthen their ethical decision-making abilities over time.

79. A firm's goal in training and education should go beyond gaining knowledge of ethical standards or how to address particular scenarios to include making sure that the consideration of ethical matters is integrated into the decision-making of PAs and that staff will also bring ethics to the forefront of their decision-making.

80. It is important that ethics education and training programs are provided to staff from all professional service areas and that such programs are no less demanding for those working in areas with less regulatory supervision, such as strategy consulting. It is important that all staff have the same level of appreciation of the importance of ethics and the firm's public interest responsibilities, notwithstanding their professional qualifications and affiliations.

Common Characteristics of an Ethical Firm

81. In considering ethical leadership and a governance framework that will drive strong ethical culture and behavior within a firm, the FCGWG has identified some common characteristics of what a firm would look like when it is functioning within such an ethical environment:

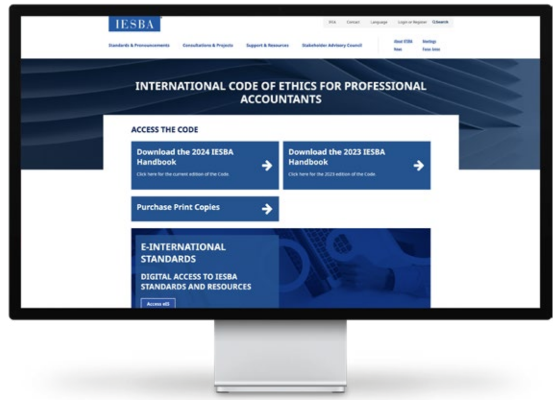
- Senior leadership who are committed to putting ethics, trust and public interest as a top priority, demonstrated through their strategies, actions and decisions. Such leadership is also committed to continuously monitoring, assessing and improving the firm's ethical culture and performance.
- New partners and senior leaders are able to demonstrate their commitment to the firm's ethical values and have records of strong ethical performance.
- A strong commitment to ethical behavior and to act in the public interest also demonstrated by partners and staff at all levels of the firm.
- Whole-of-firm mechanisms, policies and procedures within its broad governance framework embed strong ethical values.
- Staff performance assessment at all levels includes measures on ethical performance.
- Non-compliance with ethical standards is detected early and addressed promptly and appropriately in a transparent manner, demonstrating the firm's commitment to ethical values.
- Partners and staff have a strong understanding of the relevant ethics code and have an ethical mindset that takes into account ethical considerations in all their decision-making.
- Partners and staff feel comfortable with reporting unethical behavior as well as challenging each other's views and ideas.
- The firm is transparent about its ethical performance and has open discussions with regulators on addressing ethical issues. It is also open to input from independent persons who can provide objective advice on strategic matters from an ethics and public interest perspective.

82. The FCGWG envisages that these characteristics, and related matters, will be explored in the course of further consultation undertaken in developing the standards and NAM envisaged in the FCGWG's recommendations set out in Section V below.

The Role of the IESBA Code

83. The dynamic and complex nature of the business environment presents significant challenges to the crafting of effective laws and regulations on governance frameworks and structures. In such an environment, rigid regulations and rules-based approaches may fail to address all the nuances and specific circumstances encountered in practice, necessitating a more adaptable approach.

84. Based on the FCGWG outreach to stakeholders[15] and the reflection and assessment undertaken, the FCGWG concluded that a principles-based approach could provide the necessary flexibility to firms. Additionally, a principles-based approach would avoid the 'checkbox' mentality and practice that a rules-based approach may trigger, leading to superficial and formal compliance rather than genuine commitment to ethical standards.



85. The FCGWG is of the view that, whilst it would not be appropriate for the Code to address matters relating to the legal structure of firms or attempt to prescribe the services they should or should not provide, the Code could be a platform to establish a global baseline that sets out a culture and governance framework to be applied by firms and networks across all jurisdictions to address the public interest issues highlighted above, and to assist firms in building ethical cultures that will drive ethical behavior. As such a framework would be principles-based, it would have the necessary flexibility to allow regulators, NSS or relevant local bodies to develop areas as they consider appropriate. As highlighted in paragraph 27 above and Appendix Three, the extant Code already highlights the impact of the ethical culture of a firm or a PA's employing organization in relation to ethical behavior, and the critical role of senior leadership in fostering and leading an ethics-based culture within firms. However, the FCGWG has identified several areas where the Code might be strengthened:

- The provisions relevant to firm culture and governance were added under different projects and are in different parts of the Code. This may make it difficult for users to gain a holistic view of how the Code addresses these issues. It would be more convenient if there is one Section in the Code that addressed the issues relating to firm culture and governance.
- Whilst Section 120 mentions some of the factors influencing firm culture, such as leadership, education and training, and policies on reporting actual or suspected illegal or unethical behavior, including whistleblowing, it does not provide any further guidance. Also, those factors do not cover all the culture and governance elements identified during the FCGWG's information gathering, such as leadership, accountability, and rewards and recognition.
- The Code does not provide sufficient guidance on certain areas where more support may be warranted. For example:
  - The extant provision on leadership is only brief, given the importance of leadership in influencing ethical culture.
  - The policies on reporting illegal or unethical behavior, including whistleblowing, may be expanded to cover other aspects of a culture of open discussion and challenge.
  - The IESBA Code could emphasize the need for firms to incorporate ethical performance as part their performance management.

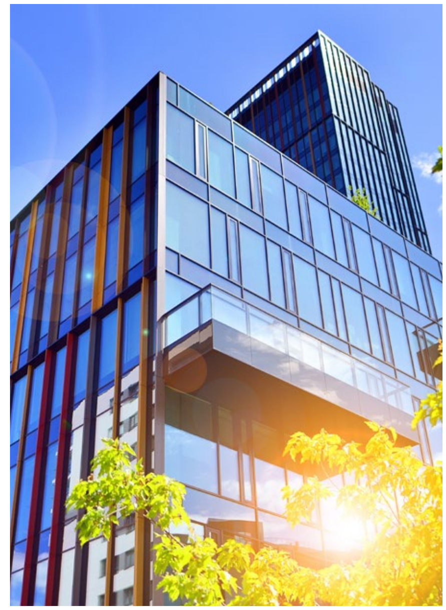
86. It is also important that the IESBA coordinate closely with the IAASB to ensure that any new standards or provisions in the Code that apply to the whole firm and all service lines complement the requirements set out in ISQM 1 for firms to design, implement and operate a SOQM for audits or reviews of financial statements, or other assurance or related services engagements.

[15] SAC, NSS

The Ecosystem

87. The promotion of ethical behavior in firms does not take place in a vacuum. While firms play a key role and have the ultimate responsibility for their ethical culture, there are other bodies whose roles and responsibilities impact how firms nurture their ethical culture. Therefore, all the relevant players in the ecosystem must interact appropriately to create ethical behavior within firms.

External Investment in Accounting Firms



88. The involvement of private equity firms is an important recent development within the accountancy profession. A typical private equity business model involves restructuring, expanding, or enhancing an entity's value before eventually exiting through a sale or public offering. Private equity investments have the potential to significantly impact the ethical culture and governance of the firms involved, with some of them, like companies and investors, being the ultimate beneficiaries of such an improvement.

89. Upon review of the information received, the FCGWG concluded that:

- The Code and local ethics codes apply to professional accountants, firms and networks regardless of ownership structures.
- The IESBA should monitor this trend, including any regulatory developments.
- It would be premature to reach conclusions on the implications of external investment in circumstances where the structures to achieve such investment remain uncertain.
- Proposals to address the implications of external investment would potentially divert attention from the objectives of the new standard-setting project recommended by the FCGWG (Section V).

90. The FCGWG also recognizes that it is not within the IESBA's remit to provide a view on which ownership or legal structure is most suitable for firms nor to assess the merits of any particular structure. However, it acknowledges that the influence of ownership structures, including external equity investment, can have an impact on the firm's culture. Upon deliberation at its September 2024 meeting, the IESBA agreed that its Emerging Issues and Outreach Committee (EIOC) will conduct further research to understand its broader implications better with the view of releasing IESBA Staff publications in the first half of 2025.

91. However, the output from the proposed FCG project would be applicable to all firms regardless of whether there is private equity investment in the firm or not.

V. WORKING GROUP RECOMMENDATIONS

92. The FCGWG recommends that it develops an accompanying summary statement to be released alongside the final report in Q1 of 2025.

93. The FCGWG recommends a project with two work streams be commenced in 2025:

- The development of a new Standard to establish a firm culture and governance framework that embeds ethical values and establishes a strong ethical culture. The new Standard will be principles-based, scalable, and applicable across all service lines of the firm.
- The development of NAMs covering key topics that will complement the work of the standard-setting work stream.

Standard-setting Project

94. The FCGWG recommends that the IESBA undertake a standard-setting project to develop a new Standard that would promote the establishment of ethical culture within firms through the development of strong ethical leadership and a robust culture and governance framework that embeds strong ethical values.

95. Taking into account the public interest issues highlighted in Section IV, the project should aim to achieve the objective of developing a firm culture and governance framework that promotes, supports and reinforces a high standard of ethical behavior across all of a firm's services, thereby helping the firm develop a reputation as a highly ethical firm, mitigate the risks of unethical behavior and strengthen public trust and confidence in all of its services.

96. To achieve this objective, the project will establish a global baseline for how firms should develop a culture and governance framework, covering its leadership, oversight, governance, and other mechanisms that embed ethical values. These provisions will take into account the ethical issues and considerations highlighted in this Report, addressing the importance of:

(a) Leaders committed to and responsible for the promotion and monitoring of ethical values and behavior within the firm.

(b) A firm-wide governance framework that supports and promotes ethical behavior that includes the areas set out in paragraphs (c) to (i) below.

(c) An accountability mechanism that is embedded throughout the firm and applicable to all partners and staff.

(d) Input by independent persons (such as independent non-executives) promoting the firm's commitment to its ethical values and its responsibility to act in the public interest.

(e) Performance management that incentivizes ethical behavior, including rewards and recognition.

(f) Being transparent to regulators and other stakeholders, including the public, about its ethical performance.

(g) The promotion and facilitation of a culture of open discussion and challenge.

(h) Education and training programs that highlight the importance of ethical behavior.

(i) Mechanisms to monitor and improve the ethical performance of a firm.

97. The new Standard should:

- Be principles-based.
- Apply to the firm's leadership, other partners, and staff as well as across all service lines of the firm.
- Be scalable to fit the different sizes of firms, from small practices to large firms with global networks. For instance, consideration may be given to whether there should be any size threshold for the use of INEs.

98. With regard to the presentation of the FCG provisions:

- The FCGWG has considered a number of possible options for the location of the FCG provisions, including Part 3 of the Code or a new Part within the Code, for further consideration by the project team.
- However, recognizing that their final form will influence the location of the new provisions, the FCGWG concluded that it would be premature to express a view on how the proposed provisions should be presented and where the proposed provisions should be located.

99. To indicate how the project team might implement the FCGWG's recommended approach, the FCGWG has developed four illustrative examples of possible requirements and identified the application material that might support those requirements[16] (see Appendix Nine).

Non-Authoritative Materials (NAMs)

100. The FCGWG recommends that a series of NAMs be developed to help firms implement the necessary culture and governance framework and related mechanisms that promote strong ethical values and culture. These guidance materials will complement the standard-setting project and may be in different formats, such as white papers, thought pieces and policy statements. The IESBA may also collaborate with other stakeholders such as NSS to develop these materials.

101. At the time of this Report, the FCGWG has identified the following potential NAM topics:

(a) **Importance of Ethical Culture in Driving Behavior**
NAM on this topic will highlight the importance of ethical culture in driving ethical behaviour within firms. It will touch on the key factors identified in this Report that contribute to a strong ethical culture across the whole firm, such as leadership commitment, transparency, and accountability, and expand on how these factors can be embedded in a firm's structure and operations.

(b) **Common Characteristics of an Ethical Firm**
This topic will build on the FCGWG's view on the common characteristics of an ethical firm highlighted in this Report and further develop these characteristics that are common to all firms irrespective of the types of services provided or jurisdictions.

(c) **The Contributions of Stakeholders within the Ecosystem in Promoting Ethical Behavior**
The topic will discuss the role of various key stakeholders within the ecosystem — such as regulators, investors, TCWG, and PAOs — in promoting ethical behavior within firms. This NAM will emphasize the importance of appropriate interaction amongst these stakeholders and with firms to ensure a comprehensive approach to ethics. Individually and collectively, these stakeholders play a crucial role in setting expectations, offering guidance, and in certain circumstances providing oversight and enforcement where appropriate.

[16] It is important to emphasize that these are for illustrative purposes only.

102. In the course of this new work stream and the standard-setting project, the IESBA may also identify other topics that should be included as NAMs.

The Way Forward

103. Subject to IESBA approval of the recommendations set out above, the FCGWG proposes that the two work streams be progressed in accordance with the FCGWG's project proposal.

104. As part of the project proposal, the FCGWG recommends that global in-person public consultation or roundtable be undertaken in Q1 and Q2 of 2025. Dialogues with stakeholders will help inform both work streams and will provide important feedback on matters, such as additional topics to be addressed in the NAM, the proposed scope and applicability of the new standards, as well as feedback on any preliminary or illustrative drafts.

105. The FCGWG also highlights the importance of collaborating with the IAASB to ensure that the new Standard on firm culture and governance aligns with and is interoperable with the principles of ISQM 1.

APPENDIX ONE

Summary of Stakeholder Outreach Feedback

1. The Firm Culture and Governance Working Group (FCGWG) conducted an extensive outreach program throughout 2024 as part of its information gathering (See Appendix Seven for a list of the stakeholders). The following is a summary of the key comments and views from stakeholders, divided into the following key themes:

Role of the Profession and Public Interest

2. Stakeholders universally recognize that firms and PAs have a responsibility to act in the public interest and maintain public trust.[17] Acting in the public interest is crucial for PAs because their work may impact the profession, investors and users of financial and non-financial information, capital markets and the public at large. PAs must adhere to the highest ethical standards to ensure the credibility of their judgments and build trust in the reliability and quality of their services and products.[18]

3. Stakeholders have highlighted the challenges that firms might face in fulfilling this public interest responsibility. While PAs are expected to consider their clients' needs and interests, they must also serve the broader public interest, which can create tension and lead to ethical dilemmas.

[17] Paragraph 100.1 of the IESBA Code states that a distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Apart from the Code, other notable standard-setting and regulatory bodies such as the US Public Company Accounting Oversight Board (PCAOB), European Federation of Accountants and Auditors (EFAA), UK FRC, United Nations Conference on Trade and Development (UNCTAD), World Bank, International Integrated Reporting Council (IIRC) collectively provide a broad perspective on the role of the accountancy profession in serving the public interest, emphasizing ethical conduct, transparency, and accountability.

[18] https://www.sec.gov/newsroom/speeches-statements/munter-20220608

4. Stakeholders emphasized the delicate balance that firms must navigate between pursuing revenue growth and fulfilling their public interest responsibilities.[19] Invariably, firms must make investments in technology and people to meet their obligations and remain profitable to ensure their long-term sustainability. However, such commercial pressures should not compromise acting in the public interest in providing professional services, as ethical lapses can have significant consequences and erode public trust. Discussions indicated that ethical dilemmas often arise from pressure to achieve key performance indicators (KPIs).[20] These pressures may lead to compromising ethical standards to meet financial or operational targets set by top management. The pursuit of KPIs associated with revenue or profits at the expense of adherence to ethical principles can lead to a culture where substandard work or unethical behavior becomes normalized, ultimately harming the firm's and the profession's reputation and the broader public interest.[21]

Role of Leadership

5. Stakeholders generally agreed that leadership plays a pivotal role in fostering an ethical culture within a firm, aligning behavior with ethical commitments, and setting the overall tone for conduct throughout the firm.[22] This concept, often referred to as "tone at the top,"[23] underscores the immense responsibility leaders have in shaping and maintaining an ethical culture. They are not only expected to articulate the importance of ethical behavior but must also lead by example, exemplifying these values through their actions and decisions.[24]

6. Leaders must consistently demonstrate ethical conduct, build trust, and foster an ethical culture, all the while complying with ethical obligations notwithstanding external pressures they may face. The FCGWG has heard that one significant challenge arises when senior leaders focus excessively on financial performance, which can compromise ethical standards. Several stakeholders highlighted that revenue-based incentives can drive inappropriate behavior, illustrating the conflict between financial goals and ethical commitments.[25]

7. Stakeholders[26] agreed that firm leaders bear significant responsibility for maintaining ethical standards and that there should be clear leadership accountability.

8. Leaders must commit to clear and honest communication, not only within their firm but also to global leadership and network firms. Local managing partners should be accountable to global leadership for there to be effective governance of a global network. These local leaders play a pivotal role in implementing the firm's global ethical policies and practices within their respective countries or regions. Their accountability to global leadership ensures that local practices align with the firm's global ethical policies and practices, creating a cohesive organizational culture where ethical behavior is consistently prioritized and reinforced at all levels.[27]

9. Representatives from the larger firms have explained to the FCGWG that their leaders, whether at the global or local level, are required to prioritize ethical values over short-term financial results, reinforced through transparent reporting of incentives and performance metrics. By clearly communicating the criteria for success and the rewards associated with ethical behavior, firm representatives pointed out that their senior leadership demonstrates that achieving financial KPIs alone is insufficient if quality and ethical objectives are not met. This approach aims to ensure that the firm's leadership's commitment to ethical standards is evident in every decision and action taken.

19 Regulators, SAC, NSS, Professional Accountancy Organizations (PAOs)

20 Regulators, NSS, Firms, PAOs

21 Switkowski Report (2023) (https://www.pwc.com.au/about-us/commitments-to-change/independent-review-of-governance-culture-and-accountability-at-pwc-australia.pdf)

22 Regulators, SAC, NSS, Firms, PAOs, Those Charged with Governance

23 "Tone at the top" is a term that originated in the field of accounting and is used to describe an organization's general ethical climate, as established by its board of directors, audit committee, and senior management. Having good tone at the top is believed by business ethics experts to help prevent fraud and other unethical practices. (Pickerd et al, 2015)

24 The Sarbanes-Oxley Act (SOX) (2002) emphasizes the importance of "tone at the top" as a critical component of effective corporate governance and internal control environments.

25 Regulators, SAC, NSS, Firms, PAOs

26 Regulators, SAC, NSS, Firms, PAOs, Those Charged with Governance

27 The study by Treviño et al. (2006), "Behavioral Ethics in Organizations: A Review," discusses ethical decision-making as a complex process influenced by individual and organizational factors. It highlights the role of moral awareness, where recognizing an ethical issue is the first step. The decision-making process involves evaluating the ethical aspects of different options, considering personal values, cognitive biases, and the organizational context. The study emphasizes the importance of ethical leadership in guiding employees toward making ethical decisions.

Governance Framework

10. All stakeholder groups generally acknowledged that a robust governance framework is crucial for maintaining ethical standards. Some stakeholders have pointed out the interrelationship between leadership and governance framework, both of which are needed in creating a firm-wide ethical culture. Robust governance frameworks are essential in creating a culture of ethical compliance by establishing structures, systems, and processes that uphold ethical standards even when under pressure. Such frameworks ensure that ethical considerations are embedded in decision-making processes and that leaders are held accountable for their actions.

11. One stakeholder has used the term "systemically important firms" to denote firms that have reached a certain size with "industry and economy-wide effects in a local jurisdiction," which result in greater public demand for transparency and public accountability placed upon them.[28] In this regard, some stakeholders[29] have suggested that the reporting, accountability and other governance requirements of partnerships may be less stringent than those for public companies.[30]

Independent Non-Executives

12. Stakeholders highlighted that in certain jurisdictions, firms' governance has been strengthened by the introduction of independent non-executives (INEs).[31]

13. INEs provide independent input to a firm's decision-making process through the lens of public interest. They typically provide advice on a firm's oversight over key strategy and policy matters such as the appointment of the head of service lines. Their roles however may vary from firm to firm depending on the firm's governance structure and size.

14. The United Kingdom Financial Reporting Council's (UK FRC) Audit Firm Governance Code (April 2022) (UK AFGC, UK Code) requires the appointment of INEs to a firm's governance structure. Discussions with stakeholders[32] in the UK suggest that the selection process for INEs is rigorous, prioritizing candidates who demonstrate a strong commitment to public interest, ethical standards, absence of conflicts of interest, and governance excellence. Appointed INEs in the UK have regular meetings with UK FRC staff to discuss public interest issues, emerging risks, and strategies to enhance governance practices within firms.

15. In Japan, firms have also adopted stringent protocols to ensure that INEs are involved in critical decision-making processes, including regular meetings where INEs provide independent assessments of proposed business strategies and ensure that all decisions are made with a high degree of transparency and accountability. In Germany, firms have benefited from the expertise of INEs despite not being a mandatory requirement and benchmarking their governance practices against international standards.[33]

16. As part of its outreach efforts, the FCGWG learned that some firms have appointed INEs in various jurisdictions, even though such appointments are not explicitly required by governance codes, laws, or regulations.[34]

[28] According to Jeremy Hirschhorn (Second Commissioner, Client Engagement Group at Australian Tax Office), "once a firm gets to a particular size, it fundamentally changes how it should think about itself and indeed how society will think about it. Our concept of 'systemically important' is a firm that has industry or economy wide effects in a local jurisdiction. Naturally, we say that once you get to that size, public interest is much more important because you can change how things work in your society. Being systemically important brings a greater demand for transparency and public accountability and when I look at the big firms in Australia, we see them as systemically important across four distinct markets: financial statements audits, large market tax advice, private sector consulting and government consulting. This of course may not be the case in all jurisdiction" (April 17, 2024) (https://www.linkedin.com/pulse/firm-culture-governance-jeremy-hirschhorn-hs9lc).

[29] NSS, Investors

[30] The Australian Treasury issued a consultation paper in May 2024. In the paper, it addresses issues related to the adequacy of prescribed governance requirements for large partnerships, the lack of mandated transparency requirements for partnerships, and the potential for inadequate accountability mechanisms within economically significant partnerships. It seeks feedback on whether the current regulatory framework in Australia sufficiently protects the interests of stakeholders and maintains appropriate governance standards in large accounting partnerships.

[31] In the UK and Japan, there are audit firm governance codes that mandate the responsibilities of Independent Non-Executives (INEs) and Audit Non-Executives (ANEs) in firms.

[32] Regulators, INEs

[33] As per German Corporate Governance Kodex 2022, listed companies must have independent members of the supervisory board. There is currently no mandatory regulation for firms to appoint INEs.

[34] For example, PwC, KPMG in Australia have announced the appointments of new independent directors to their Boards.

Network

17. As firms' networks expand geographically, they encounter diverse cultural norms and practices, which can complicate efforts to uphold consistent ethical standards across their networks.[35] This necessitates a clear delineation of responsibilities within firms, ensuring there is a clear line of responsibility for overseeing and enforcing ethical behavior across the firm and its network.[36] Mechanisms to hold global and local leadership accountable for network failures are essential for maintaining consistency and integrity across global operations.

18. The growth of multi-disciplinary firms,[37] which often operate as networks and affiliates, also raises concerns about the adequacy of penalties for breaches of ethical conduct.[38] Some stakeholders called for accountability mechanisms within these networks to ensure compliance with ethical and professional standards.

19. Representatives from firms and PAOs have highlighted a number of challenges with implementing a global baseline of ethical culture (a uniform set of ethical standards and practices across all network firms) such as cultural misalignment, inconsistent enforcement, and resistance due to differing local norms and regulations. These issues underscore the complexity of maintaining uniform ethical standards within a global network of firms, where the ethical lapses of any member firm may have a detrimental impact on the global firm.

Other Elements

20. Stakeholders have also identified other elements of the governance framework that may impact a firm's culture (see discussion below).

Accountability Across the Firm

21. Stakeholders highlighted that accountability must extend beyond leadership to include all partners and staff within the firm. Accountability needs to be taught from the most junior level so that all staff understand what accountability means. Whole-of-firm accountability is essential because it ensures consistency in upholding ethical standards. When accountability is extended to every staff member, it also promotes shared responsibility—making it clear that each individual's actions matter and contribute to the ethical standing of the firm.

22. Mechanisms such as regular performance reviews, monitoring processes and comprehensive compliance reporting play a key role in this process. These tools ensure that employees' actions are monitored and assessed against ethical standards, providing an opportunity to address any deviations early. By holding all employees accountable, firms foster a more transparent and ethical working environment, reducing the risk of misconduct and ensuring that everyone upholds the firm's values.

Rewards and Recognition

23. Stakeholders[39] have emphasized the significant role of rewards and recognition in driving behavior within firms and the importance of aligning incentives with ethical behavior in fostering an ethical culture. This alignment motivates employees, ensuring that performance evaluations and rewards reflect the firm's commitment to ethics and integrity. When employees see that ethical behavior is recognized and rewarded, they are more likely to prioritize ethical considerations in their work. By aligning incentives, rewards and recognition with ethical behavior, firms can create an environment where employees are driven to act ethically.

[35] Jeremy Hirschhorn (April 17, 2024) (https://www.linkedin.com/pulse/firm-culture-governance-jeremy-hirschhorn-hs9lc).

[36] According to each firm's site, Deloitte's network of member firms spans more than 150 countries and territories, PwC in over 151 countries, KPMG firms operate in 143 countries and territories and EY in over 150 countries.

[37] Over the past decade, the consulting arms of accounting firms have witnessed exponential growth, significantly outpacing their traditional audit practices.

[38] Regulators, Firms, PAOs

[39] Regulators, SAC, Firms, PAOs

24. Therefore, stakeholders expressed the need for firms to carefully design their incentive structures, recognizing that poorly designed incentives can lead to unintended consequences.[40] One stakeholder has particularly observed[41] that while there are strong incentive structures for certain behaviors, the disincentive structures (penalties or negative consequences) for unethical behavior are often weak.

25. Firm representatives have stated that performance evaluations in their firms are based on both qualitative and quantitative measures, with compliance with ethical policies being a critical criterion. Failure to meet these ethical standards results in negative performance evaluations and impacts rewards such as bonuses. While traditional KPIs often focus primarily on financial metrics, it is essential to build in non-financial metrics that incorporate ethical behavior. This means developing KPIs that measure adherence to ethical standards, the effectiveness of ethical training programs, and the firm's overall ethical culture.[42] Firm representatives consistently stressed that compliance with their ethical code of conduct is equally crucial for all employees, regardless of their position within the firm—be it partners or staff. This aims to ensure that all individuals within a firm are held to the same high standards, promoting a consistent and unified approach to ethical decision-making and conduct.

Transparency

26. Firms are increasingly encouraged to implement transparent reporting mechanisms to provide stakeholders with clear views of their operations and ethical performance.[43] For example, in the United Kingdom, the UK AFGC mandates transparency reports for audit firms that audit public interest entities (PIEs). These reports provide stakeholders, including investors, regulators, and the public, with information about the audit firm's governance, internal controls, quality assurance measures, and independence practices. Similarly, in the European Union (EU)[44] and Australia,[45] there is legislation that mandates transparency reports from audit firms that audit public interest entities. In other jurisdictions, such as the United States and Singapore, some firms publish transparency reports on a voluntary basis.

27. Stakeholders also shared that transparency about ethical breaches and corrective actions are equally important. Being open about ethical lapses and the steps taken to address them shows a commitment to accountability and continuous improvement, helping build a culture where ethical behavior is expected, and deviations are promptly addressed and corrected. According to some stakeholders,[46] detailed disclosures about how firms manage ethical risks and ensure compliance with ethical standards help maintain ethical standards and accountability and inform stakeholders about a firm's commitment to ethics.

Education and Training

28. Another important element that helps instill an ethical culture within firms is education.[47] Continuous education and training in ethics and quality management are essential for maintaining a high level of compliance with professional standards. By integrating ethics education into regular training programs, firms ensure that all partners and staff understand and appreciate the importance of ethical behavior. This becomes even more critical in light of recent cheating scandals within firms,[48] which have severely impacted their reputations and trustworthiness. These scandals highlight the importance of firm leadership in preventing such incidents from recurring.[49] Some stakeholders have also suggested that staff turnover necessitates ongoing professional training.

[40] In his report, Dr Switkowski said even though the personnel at PwC Australia were "smart, high-achieving … and dedicated to delivering quality outcomes for their clients", the firm's emphasis on profit led to the development of a "shadow side" that caused dysfunctional behaviour across the firm. "Overall, interviewees and focus groups reported that conversations about purpose and values have declined and receive less consideration in decision-making," he wrote in the report. "The mindset was said to have been 'growth at all costs' with a spotlight on 'revenue, revenue, revenue'.

[41] Regulator

[42] Regulators, SAC, Firms, PAOs

[43] Regulators, SAC, Firms

[44] European statutory audit regulations (Article 13 of Regulation (EU) 537/2014)

[45] Section 332 of the Corporations Act (https://asic.gov.au/regulatory-resources/financial-reporting-and-audit/auditors/audit-transparency-reports/)

[46] SAC, TCWG

[47] Regulators, SAC, NSS, Firms, PAOs, Those Charged with Governance

[48] Cheating scandals have involved the Big Four firms spanning from 2019 to 2024. Refer to Appendix Eight.

[49] The Canadian Public Accountability Board (CPAB) Audit Quality Insights Report: 2022 Interim Inspections Results emphasizes the significance of firm culture in ensuring audit quality. It highlights two major enforcement actions related to improper behaviors: audit staff sharing test answers for mandatory training and backdating work paper signoffs. The report underscores the importance of leadership in fostering a corporate culture focused on integrity.

29. While firms conduct regular ethics training, it is equally important to focus on how these principles are taught to ensure that they resonate with partners and staff at all levels. The learning environment plays a crucial role in this process. Firm personnel need to be trained not just to understand ethical rules but to develop the judgment to spot ethical issues in their everyday work. This includes providing junior staff with opportunities to build their ethical capacity and helping them strengthen their ethical decision-making abilities over time. Training should be interactive and reflective, encouraging staff to engage with real-world scenarios where ethical issues may arise and enabling them to learn how to navigate these situations effectively.

30. The growth of consulting services in firms necessitates a rigorous process to ensure that personnel are appropriately onboarded.[50] The FCGWG has heard that ensuring that non-PAs adhere to the same ethical standards as PAs may be a challenge for some multidisciplinary firms. Non-PAs from different professional backgrounds (e.g., engineering or IT) would have received different professional ethics training and, unlike their PA counterparts, would not be familiar with the IESBA Code and applicable professional standards. This makes it essential for firms to ensure that these employees receive comprehensive ethics training that enables them to not only understand the standards but also to recognize ethical risks specific to their professional roles. Ensuring a consistent ethical culture across all service lines requires ongoing efforts to integrate ethics into the onboarding process and to continuously develop employees' ethical judgment, regardless of their background or seniority.

31. Stakeholders stressed the need for robust education and training programs to keep professional accountants updated with the latest ethical standards.[51] Firms are increasing their education efforts, particularly for those parts of the firm that are not involved in the audit business line.[52] Stakeholders believed that all players in the ecosystem[53] need to deliver consistent messages to reinforce the desired ethical mindset across the profession. This view is evidenced in a study by Low et al. (2008)[54], which critiqued the inadequacies of the current university curriculum in ethics education. They advocate a comprehensive overhaul of accounting education to include robust ethics training, [55] emphasizing the need for educational institutions and professional bodies to work together to foster a culture of ethics.

Culture of Open Discussion and Challenge

32. All stakeholders shared the view that maintaining an ethical culture requires fostering a culture where employees can speak up and raise concerns without fear of retribution — a culture of open discussion and challenge.[56] Employees should feel safe discussing and questioning practices and decisions openly. This approach promotes transparency and accountability, allowing issues to be addressed before they escalate.

33. The Broderick (2023) review[57] of EY Oceania highlights the importance of building a culture where employees feel comfortable raising concerns. It emphasizes that creating such an environment involves not only having formal systems in place but also nurturing an atmosphere of mutual respect and trust. The review revealed that some employees[58] did not feel safe to raise concerns due to fear of retribution or negative consequences. This highlights the need for firms to actively promote an atmosphere where open dialogue is encouraged, and where employees feel secure in their ability to raise issues without fear of negative outcomes.

[50] Firms
[51] PAOs
[52] Firms
[53] Other players in the ecosystem, such as the regulators and PAOs.
[54] Low, M., Davey, H., & Hooper, K. (2008). "Accounting scandals, ethical dilemmas and educational challenges". Critical Perspectives on Accounting, 19(2), 222-254.
[55] Low et al. (2008) identified five critical factors influencing accounting scandals: a corporate culture that prioritizes profit over ethics, inadequate regulatory oversight, insufficient ethics training in accounting programs, the personal ethical standards of accountants, and the role of professional organizations in promoting ethical standards.
[56] Some firms prefer the term "culture of consultation and challenge" or "speak up" over "whistleblowing," viewing it as more conducive to fostering an open and ethical work environment.
[57] The tragic passing of Aishwarya Venkatachalam, a young Indian-Australian auditor, at the EY Oceania Sydney premises in August 2022, provided an important impetus for the Executive Leadership Team (ELT) to commission this independent Review of the firm's workplace culture.
[58] In the report, the % of employees who did not feel safe to raise concerns varied depending on whether it was related to bullying, sexual harassment or racism.

34. Stakeholders[59] noted that reported concerns must be taken seriously and investigated thoroughly. Swift and fair resolution of issues reinforces the firm's commitment to ethical behavior and shows employees their concerns are valued. Training programs are in place within the firms to educate employees about the importance of raising ethical concerns and the protections available to them. These programs help employees understand their rights and the mechanisms in place to support them when they raise concerns. In conversations with the firms, they confirmed that there are robust and secure reporting systems that ensure confidentiality and protection from retaliation. For instance, at the Big Four firms, employees are encouraged to use their "Speak Up" helpline (or a similar named helpline or mechanism), which allows them to raise concerns anonymously.

35. A healthy culture of open discussion and challenge also goes beyond traditional whistleblowing programs or speak-up mechanisms to voice concerns about ethical or other behavioral issues. This culture also extends to creating a workplace environment where staff can speak their mind, be curious and constructively challenge the views of their superiors or their colleagues, which will foster mutual learning within a team and improve the quality of their work. Encouraging these exchanges not only improves ethical decision-making but also cultivates an environment where innovation and critical thinking thrive.

36. Discussions with stakeholders also highlighted that culture surveys and assessments can be helpful tools for gauging the effectiveness of ethical practices, employee engagement, and overall satisfaction within the firm. [60]

Trends in Accounting Firms

Growth of Consulting Services

37. Over the past decade, firms' consulting arms have continued to experience exponential growth, significantly outpacing their traditional audit practices. This surge is driven by the escalating complexity of modern business environments and the heightened demand from the private and public sectors for specialized consulting expertise.[61] As a result, the size and scope of consulting businesses within firms have increased substantially. For instance, in Australia and the UK, over 70% of the Big Four firms' revenue comes from consulting clients.[62] [63]

38. Certain consulting services, such as tax planning, insolvency, financial planning, and valuations, are generally subject to professional standards, laws, and regulations. However, other services, such as strategy consulting or systems development, may be subject to little or no regulatory supervision. This gives rise to the perception that the regulatory framework for non-audit services, particularly consulting,[64] significantly lags behind that of audit services. The absence of specific regulations governing some consulting practices necessitates reliance on self-regulation, which may not be as rigorous as statutory regulation.

39. One observation raised by stakeholders about the growth of consulting services within firms is the influx of new hires at all levels who are not PAs or from the accountancy profession. Whilst acknowledging that these non-PAs may be subject to other codes of ethics as part of their professional affiliation, some stakeholders have raised concerns about whether this growth of non-PAs in firms will result in more staff not having an adequate understanding of the IESBA Code and dilute the firm's collective understanding of its role to act in the public interest. In this regard, firms have informed the FCGWG that all new staff are subject to the same robust training on ethics irrespective of whether they are PAs or non-PAs, and partners are required to undergo further training.

[59] Firms, INEs

[60] Discussions with UK FRC representatives noted that these assessments are shared with them as part of the annual thematic review of firm's audit firm governance and corporate culture compliance.

[61] https://gusto.com/partner-resources/research-how-accounting-firms-are-evolving-2023

[62] Refer to page 24 of the Australian Treasury Consultation Paper, *Regulation of Accounting, Auditing and Consulting firms in Australia,* May 2024 which states that for the year 2023, the total combined % of revenue from non-audit services for non-audit clients were 79%.

[63] Refer to page 50 of the UK FRC's August 2023 report on *Key Facts and Trends in the Accountancy Profession* which shows total fee income from non-audit clients from Big Four UK firms.

[64] Management and assurance of integrity by consulting services (Australian Senate June 2024)

Private Equity Investment in Firms

40. Private equity (PE) investment in firms may involve the infusion of capital from PE firms into target firms,[65] often with the goal of restructuring, expanding, or enhancing the firm's value before eventually exiting through a sale or public offering. PE investment can be a significant catalyst for growth and innovation, particularly for firms that require substantial capital for development projects, operational improvements, or market expansion.[66]

41. However, stakeholders[67] expressed concern that PE investment also comes with certain challenges and requires careful consideration of a range of issues, such as a firm's ethical culture, auditor independence, and audit quality.[68] The involvement of PE firms may lead to changes in governance, with the investors seeking significant influence or control over key strategic decisions. This can sometimes create friction with existing leadership, particularly if there are differences in vision or strategy. Additionally, the focus on achieving a high return on investment within a specific timeframe can lead to pressure on the firm to deliver short-term performance improvements that drive up profitability at the expense of long-term sustainability and performance. This may result in cost-cutting measures that will affect the quality of the firm's service offerings. Such measures may include reducing investment in staff training and technology and cutting back on resources.

42. Firms emphasize professional ethics, independence, and long-term client relationships, which can be at odds with the PE focus on rapid financial returns. The introduction of PE investment can lead to a shift in priorities, where financial metrics may overshadow these core values, potentially undermining the ethical standards and professional independence that are critical in audit practices.[69]

The Ecosystem

43. Ensuring that firms act in the public interest and uphold high ethical standards requires a concerted effort that extends beyond a firm's leadership and internal governance mechanisms. This highlights the importance of proper interactions among these stakeholders, including regulators, standard setters, those charged with governance at clients or employers, investors, and professional associations and with firms. Such interactions are essential not only for supporting ethical conduct but also for delivering high-quality work.

44. For instance, the Australian Treasury's recent consultation paper[70] on the Regulation of accounting, auditing and consulting firms in Australia discussed regulatory frameworks of audits, tax services and other consulting services, the role of professional standards as well as the enforcement powers of key regulators relating to services including audit, insolvency and financial services and the self-regulation infrastructure that governs the accountancy profession in Australia.

45. Stakeholders have also highlighted that those charged with governance, investors and audit committees[71] also play a role in maintaining high ethical standards within firms. They should not appoint firms based solely on fees but should demand adherence to high service quality and ethical standards. This ensures that these firms are selected based on their ability to provide objective, unbiased professional services rather than on cost considerations alone. By prioritizing ethical considerations in the firms' appointments, those charged with governance, investors and audit committees can contribute to the integrity and reliability of the firms' service deliverables.

65 https://www.irishtimes.com/business/2024/06/11/private-equity-groups-poised-to-own-one-in-three-top-us-accounting-firms/
66 https://www.journalofaccountancy.com/news/2024/jun/private-equity-has-big-plans-for-small-firms.html?utm_source=mnl:cpal&utm_medium=email&utm_campaign=18Jun2024
67 SAC, Regulators
68 In an FT article, the regulator expressed concerns about whether PE ownership could change the "tone at the top" and affect the quality of audit work.
69 Paul Munter (August 2022) Auditor Independence and Ethical Responsibilities: Critical Points to Consider When Contemplating an Audit Firm Restructuring.
70 Regulation of accounting, auditing and consulting firms in Australia (May 2024)
71 Investors, SAC

APPENDIX TWO

Summary of Academic Report by Dr. Eva Tsahuridu

1. As part of its information gathering, the FCGWG engaged [Dr. Eva Tsahuridu] to prepare a report[72] on organizational culture by synthesizing findings from global academic literature on the topic of culture and governance (Academic Report). The report examined how important organizational ethical culture is in shaping ethical behavior within firms.

2. The following is a summary of the Academic Report.

What is "Culture"

3. A simple way to define culture is "the way we do things around here."[73] Schein (2010)[74] offers a descriptive definition of organizational culture with three levels of cultural analysis, namely artifacts, espoused values, and underlying assumptions. According to Schein, at the core of culture is the "shared tacit assumptions that are reflected in the values and behaviors." Therefore, Schein's analysis of culture demonstrates that culture cannot be simply based on a firm's policies, slogans, or other promotional material but on how staff may perceive it as acceptable behavior or, in other words, how they understand they should do things around here.

4. More specifically, ethical culture is "a subset of organizational culture that reflects the shared values, norms, and beliefs about what constitutes appropriate behavior shaping ethical or unethical decision-making in an organizational context"[75] or "how we do things around here in relation to ethics, an integrated system that sends messages to employees that support or do not support ethical conduct."[76]

5. The Academic Report also highlighted the presence of subcultures within organizations, which can vary significantly across departments, teams, and hierarchical levels. This concept of subculture aligns with the observations shared by stakeholders that a firm's consulting arm might have a different ethical culture than its audit arm, given that the latter is under a high level of regulatory supervision and auditors are much more familiar with the ethics and independence requirements set out in the Code.

6. Further, a number of studies identify a growing trend in accounting firms toward commercialism over public interest obligations. One study[77] highlights that accounting firms have become commercially driven over time, prioritizing revenue generation and client retention. This shift towards a commercial orientation can sometimes conflict with the ethical standards and professional values traditionally upheld in the accounting profession. The study underscores the importance of maintaining a balance between commercial success and ethical integrity, emphasizing the need for a robust ethical culture to mitigate the risks associated with this commercial emphasis.

72 Refer to Agenda item 2B – Academic Report by Dr. Eva Tsahuridu of the June 2024 IESBA Meeting

73 Deal, T. E., & Kennedy, A. A. (1982). *Corporate cultures*. Reading, MA: Addison-Wesley.

74 Schein, E. H. (2010). *Organization Culture and Leadership*. 4th ed. Jossey-Bass, San Francisco.

75 Roy, A., Newman, A., Round, H., & Bhattacharya, S. (2024). Ethical culture in Organizations: A review and agenda for future research. Business Ethics Quarterly, 34(1), p. 99.

76 Trevino, L. K., Haidt, J., & Filabi, A. E. (2017). Regulating for ethical culture. Behavioral Science & Policy, 3(2), 57-70.

77 Pierce (2007) - Page 3 of Agenda Item 2B – Academic Report by Dr. Eva Tsahuridu of the June 2024 IESBA Meeting. Pierce discusses how this commercial focus can lead to ethical dilemmas for accountants, as the pressure to meet financial targets and satisfy clients may overshadow the commitment to ethical principles and independent judgment.

Key Factors that Influence Ethical Culture

7. The Academic Report highlighted the importance of governance systems and processes and leadership in influencing ethical behavior.

Framework of Formal and Informal Systems

8. Ethical culture within an organization is a multidimensional interplay among various 'formal' and 'informal' systems of behavioral control that are capable of promoting ethical or unethical behavior.[78] In particular, the formal systems include executive leadership, employee selection systems, policies and codes, orientation and training systems, performance management systems, organizational authority structures and decision-making processes.

9. As part of its stakeholder engagement with firms, the FCGWG observed that larger firms have generally implemented these formal systems as part of their governance frameworks.

Impact of Leadership

10. Ethical leadership is the most examined antecedent of ethical culture[79] and a number of research studies highlight the importance of leadership in influencing ethical culture. For instance, Trevino et al. (2017) argue that "senior leaders are critical to establishing an ethical culture—they provide resources for effective programs, send values-based messages, and serve as role models for ethical behavior and the use of ethical language. They have the potential to influence every other system within the organization". Similarly, Schaubroeck et al. (2012)[80] found that ethical leadership creates a cascading effect, where leaders' ethical behaviors are emulated by subordinates and spread throughout the organizational hierarchy. While leadership is one of the components of ethical culture, leaders can influence all other formal and informal elements and can enable their alignment and integration.

11. Interestingly, Schein (2010) has outlined a series of leadership embedding mechanisms that create and reinforce culture, such as what leaders pay attention to, measure, and control on a regular basis, how leaders allocate resources, rewards and status, react to critical incidents and organizational crises as well as how they recruit, promote and dismiss. These mechanisms corroborate with some of the observations made by stakeholders to the FCGWG about the influence of leaders on the ethical culture of a firm, irrespective of what the stated processes or policies might be.

Impact of Ethical Culture on Ethical Behavior

12. The academic research has found that the ethical culture of an organization is probably the most important contextual element that explains unethical behavior and that there is a strong link between an organization's ethical culture and the ethical behavior of its employees.[81]

13. While individuals may know what the right thing to do is, they may not always do it due to influences and pressures, including those exerted by their context and the organization's culture. Creating "a culture that talks, thinks, and rewards ethics can help people behave ethically."

[78] Trevino, L.K., Butterfield, K.D., & McCabe, D.L. (1998). The ethical context in organizations: Influences on employee attitudes and behaviors. Business Ethics Quarterly, 8(3), 447-476.

[79] Brown & Trevino, 2006; Brown et al., 2005, Trevino et al., 2017.

[80] Schaubroeck, J. M., Hannah, S. T., Avolio, B. J., Kozlowski, S. W. J., Lord, R. G., Treviño, L. K., Dimotakis, N., & Peng, A. C. (2012). Embedding ethical leadership within and across organizational levels. Academy of Management Journal, 55(5), 1053–1078.

[81] Kaptein (2011) ; Hiekkataipale & Lämsä (2019).

14. Trevino and Brown (2004)[82], suggest that individuals tend to conform to the expectations and behaviors of those around them, which Zimbardo (2005)[83] more aptly puts as that "you cannot be a sweet cucumber in a vinegar barrel." Sharp-Paine (1994)[84] explains that unethical behavior in organizations is rarely the result of a lone individual's actions; instead, it often requires the participation and complicity of several members within the organization.

15. The FCGWG also noted in a separate literature review by Ashforth and Anand (2003)[85] that corruption becomes normalized in organizations through institutionalization, socialization, and rationalization processes, where unethical practices are embedded in routines, and new members are indoctrinated into corrupt behaviors. Justifications are created to legitimize these actions. Equally, in a study by McMahon (1995)[86], it is stated that organizational misconduct is often a collective phenomenon arising from shared values, attitudes, and behaviors that define an organization's culture. When unethical practices become embedded in the organizational culture, they are perpetuated through social norms and peer influence.

16. The Academic Report and other academic reviews carried out by the FCGWG support the view that to combat individual unethical misconduct effectively, it is crucial to address the collective ethical culture within the firm's environment and those key elements that influence such culture.

[82] Trevino, L. K., & Brown, M. E. (2004). Managing to be ethical: Debunking five business ethics myths. Academy of Management Perspectives, 18(2), 69-81.

[83] Zimbardo, P. (2005). You can't be a sweet cucumber in a vinegar barrel: A talk with Philip Zimbardo. Edge. www.edge.org/conversation/philip_zimbardo-you-cant-be-a-sweet-cucumber-in-a-vinegar-barrel.

[84] Page 7 of agenda item 2B – Academic Report by Dr. Eva Tsahuridu of the June 2024 IESBA meeting Sharp-Paine (1994) noted that unethical practices typically involve the cooperation of multiple individuals rather than the flaws of a single actor.

[85] Ashforth, B. E., & Anand, V. (2003). The normalization of corruption in organizations. Research in Organizational Behavior, 25, 1-52.

[86] McMahon, C. (1995). The ontological and moral status of organizations. Business Ethics Quarterly, 5(3), 541-554.

APPENDIX THREE

Summary of Extant Provisions in the IESBA Code

1. The following is a summary of the current provisions in the IESBA Code[87] that address the topic of firm culture and governance.

Part 1 of the Code

Sections 100 and 115

2. The first paragraph of the extant Code states that a distinguishing mark of the accountancy profession is the acceptance of its commitment to act in the public interest (paragraph 100.1). While it is appropriate to consider the interest of a client or employer when performing professional activities, professional accountants (PAs) must also consider the interest of other stakeholders (paragraph 100.6 A4).[88]

3. To further highlight the importance of public interest, the IESBA included a revised provision in Subsection 115 under its Role and Mindset Final Pronouncement. The revised provision (paragraph R115.1(b)) requires PAs to behave consistently in accordance with the profession's responsibility to act in the public interest.

Section 120

4. The Role and Mindset Final Pronouncement also added new provisions to Section 120 to expressly highlight the importance of organizational culture in influencing ethical behavior in a PA's employing organization (which includes an accounting firm).

5. Paragraph 120.13 A1 sets the scene by stating the interconnectivity between compliance with the Code and the internal culture of a PA's employing organization. Paragraph 120.13 A2 then sets out those conditions for promoting ethical culture within an organization, including ethical leadership, appropriate education and training, effective policies and procedures, and dealings with third parties. These conditions address the culture at an organizational level instead of the behavior of individual PAs. Paragraph 120.13 A3 highlights the expectations of PAs to promote an ethical culture within their organizations.

6. Paragraph 120.14 A1 notes that ISQM 1 sets out requirements and application material relating to firm culture in the context of quality management for audits, reviews, and other assurance engagements.

[87] International Code of Ethics for Professional Accountants (including International Independence Standards)

[88] In its recent Tax Planning pronouncement, the IESBA has taken the position to include specific provisions within the Code that requires PA to consider its action through an assessment of the reputational, commercial, and wider economic consequences that could arise from how stakeholders might view the tax planning arrangement.

Parts 2 and 3 of the Code

Sections 200 and 300

7. The Code recognizes that with higher positions, PAs in business (PAIBs) wield more significant influence over the firm's policies, decisions, and actions (paragraphs 200.5 A3). Consequently, senior PAIBs are expected to actively advocate for and promote an ethics-based culture within their organizations. Specific actions to achieve this may include the introduction, implementation, and oversight of ethics education and training programs, management processes for performance evaluation and reward criteria that promote an ethical culture, ethics and whistle-blowing policies, and developing and maintaining policies and procedures designed to prevent non-compliance with laws and regulations.

8. Under the IESBA's Technology project, a similar provision has been added to Section 300 (paragraph 300.5 A2) in Part 3 of the Code which is applicable to PAPPs and will become effective in December 2024.

Section 270

9. Paragraph 270.3 A3 of the extant Code provides a list of factors relevant to evaluating the level of threats to compliance with the fundamental principles. One of the factors is the culture and leadership of an employing organization to the extent that they emphasize the importance and expectation of ethical behavior. This factor also includes an example of a corporate culture that tolerates unethical behavior, which might increase the likelihood that the pressure would result in a threat to compliance with the fundamental principles.

APPENDIX FOUR

Brief Overview of Jurisdictional Audit Firm Governance Codes

1. The following is a brief overview of the audit firm governance codes by the United Kingdom Financial Reporting Council (UK FRC) and the Japan Financial Services Agency (JFSA).

Scope and Applicability

2. The UK FRC's Audit Firm Governance Code (UK AFGC, UK Code)[89] applies to audit firms[90] that audit Public Interest Entities (PIEs), including those firms where the audit practice is operationally separate from the rest of the firm. This Code is effective for financial years starting on or after January 1, 2023. Firms that audit 20 or more PIEs, or at least one FTSE 350 company, are expected to adopt the Code. However, smaller firms or those below these thresholds can apply the Code proportionately, tailored to their size and the nature of the entities they audit.

3. Japan's Audit Firm Governance Code by the Council of Experts on the Audit Firm Governance Code (Japan AFGC, Japan Code)[91] applies to all audit firms that audit one or more listed companies, accordingly, scalability was considered in various aspects. Audit firms in Japan that do not audit listed companies are not precluded from voluntarily implementing this Code. The Japanese Code is enforced under the Japan Certified Public Accountants Act.

4. Both AFGCs apply to the whole firm and not just the audit business line despite the focus on audit quality. Both Codes also allow for flexibility on how they should be implemented, taking into account the size of the firms and other circumstances, and adopt a "comply or explain approach," requiring firms to either comply with the provisions of the Codes or explain the reasons why they have not, and the alternative arrangements put in place.

[89] The UK AGFC Code is organized by theme into five sections, as follows:
- Sections A-C are directed primarily at firms applying the Code and deal with the themes of leadership, people, values, behaviors, operations, and firm resilience.
- Section D is directed primarily at INEs and Audit Non-Executives (ANEs).
- Section E is directed at firms with operationally separate audit practices and deals with the respective roles and responsibilities of INEs, who are independent members of Public Interest Bodies and the independent members of Audit Boards, known as ANEs.

[90] Although it is an Audit Firm Governance Code, the principles apply to the whole firm.

[91] The Japan AFGC Code specifies five principles:
- The Role to be Accomplished by an Audit Firm
- Management function
- Supervision and Evaluation function
- Operation
- Ensuring Transparency

Key Elements

Leadership

5. Leadership is a central component in both Codes. The UK AFGC emphasizes the need for management and governance structures that promote long-term sustainability. It stresses the importance of checks and balances to support effective management with clear lines of responsibilities, and no individual or small group should have unfettered decision-making powers. Regular dialogue with Independent Non-Executives (INEs) is also highlighted to demonstrate a commitment to the public interest.

6. The Japan AFGC recognizes the importance of those at the top in exercising leadership to fulfill the firm's public interest role and requires firms to be mindful of the tone at the top. It calls for clear management roles to meet public expectations and ensure effective management. Additionally, it includes functions for supervision and evaluation, leveraging independent third persons to enhance management effectiveness.

People and Culture

7. Both Codes highlight the importance of setting the right environment and culture. The UK AFGC states that firms are responsible for establishing and promoting a culture that supports high-quality audits, the public interest, and long-term sustainability. Similarly, the Japan AFGC requires firms to set an appropriate environment for people development, human resources management, and performance evaluation to raise the morale of firm personnel and help them maintain and demonstrate their professional competence.

8. Under both Codes, firms should also promote a culture of openness, where consultation, idea sharing, and challenges are encouraged. Both Codes also require firms to have a code of conduct that needs to be applied by the whole firm.

Provision of Independent Input

9. Both Codes stress the importance of having independent input into the firm's governance structure to challenge the decision-making of the firms and to help them meet their public interest responsibilities.

10. Under the UK Code, firms are required to appoint independent non-executives (INEs) to its governance structure to help them meet the requirements set out in the UK Code. INEs and audit non-executives (ANEs) should provide constructive challenges with a focus on the public interest and demonstrate objectivity and an independent mindset. The INEs (and ANEs) owe a duty of care to the firm and should command the respect of the firm's partners. They must have sufficient time and rights to fulfill their responsibilities effectively (e.g., access to information). The INEs (ANEs) are also required to have an open dialogue with the regulator.

11. Under the Japan AFGC, firms should utilize the knowledge and experience of independent third persons to deal with the issues from the perspective of ensuring effective management and organizational operations and accomplishing their public interest role. A firm should clarify the independent third person's role, which is expected to include oversight on a range of matters such as evaluation of the management's effectiveness, the process of election or appointment of the Managing Partner or equivalent and other senior leaders, evaluation and remuneration, and policies on whistleblowing. They are also expected to be involved in dialogue with the audit entities, shareholders, and other participants in the capital market.

Transparency

12. As highlighted in the UK AFGC, transparency is key to improving trust and confidence in audits. It further notes that reporting "enhances accountability and drives behavior, helping ensure leadership focuses on the key governance and performance issues which the Code covers." The UK AFGC requires firms to report against the UK Code that focuses on how a firm has applied the Principles in the Code in a manner that would enable stakeholders to assess how the firm has met the purposes of the UK Code and achieved the desired outcomes. Firms must also develop robust datasets and effective management information to support their ability to furnish the regulator with such information.

13. Under the Japan AGFC, firms are required to disclose their implementation status of the Japan Code as well as the effectiveness of their initiatives for the enhancement of audit quality to allow stakeholders in the capital market to assess their audit quality appropriately. Firms should also strive for proactive dialogue with the audit entity, shareholders, and other stakeholders in the capital market.

APPENDIX FIVE

Brief Overview of International Standard on Quality Management (ISQM 1)[92] – Governance and Leadership and Relevant Ethical Requirements

1. ISQM 1 addresses a firm's responsibilities in designing, implementing, and operating a system of quality management (SOQM) for audits or reviews of financial statements or other assurance or related services engagements. The objective of the SOQM is to provide the firm with reasonable assurance that both the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements. It also provides the firm with reasonable assurance that engagements reports issued by the firm or engagement partners are appropriate in the circumstances.

2. SOQMs in compliance with ISQM 1 were required to be designed and implemented by December 15, 2022.

3. ISQM 1 applies to all firms performing audits or reviews of financial statements or other assurance or related services engagements. Whilst ISQM 1 does not require the SOQM to extend to the other engagements performed by a firm, such as consulting and tax services, ISQM 1 may nonetheless affect those other engagements, operational areas of the firm, personnel of the firm who are not involved in performing engagements that require SOQM. As stated in ISQM 1, "quality management is not a separate function of a firm; it is the integration of a culture that demonstrates a commitment to quality with the firm's strategy, operational activities and business processes."[93]

4. ISQM 1 requires firms to assign responsibilities for the SOQM and other aspects of the SOQM to individuals and to hold them accountable for their assigned roles.

5. For the purposes of ISQM 1, a SOQM is designed to address eight interconnected and iterative components. These include the firm's risk assessment process, governance and leadership, relevant ethical requirements, acceptance and continuance of client relationships and specific engagements, engagement performance, resources, information and communication, and the monitoring and remediation process. Each component plays a crucial role in maintaining the overall quality of the firm's engagements and ensuring compliance with relevant standards.

[92] 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

[93] ISQM 1, paragraph A30.

Governance and Leadership

6. As highlighted in the ISQM 1 – First-Time Implementation Guide, governance and leadership are crucial to quality management at the firm and engagement level as it is the means upon which a firm embeds its culture and ethics and serves as the framework for how the firm's decisions are made.

7. In accordance with ISQM 1,[94] the governance and leadership component of the SOQM establishes the quality objectives that establish the environment that supports the SOQM.

8. Under this component, a firm must demonstrate its commitment to quality through a firm-wide culture that recognizes and reinforces the firm's role in serving the public interest through the performance of quality engagements, the importance of professional ethics, values, and attitudes, and responsibilities of all personnel and the importance of quality in the firm's strategic decisions and actions.

9. Other quality objectives emphasize the role and responsibility of leadership in quality, the demonstration of commitment to quality through actions and behavior, having the appropriate organizational structure, assigning roles and responsibilities that will support the firm's SOQM, and proper resource planning.

Relevant Ethical Requirements

10. ISQM 1 discusses ethical requirements extensively, emphasizing that firms must establish quality objectives that address their responsibilities in accordance with relevant ethical standards, including those related to independence. In particular, paragraph 29 emphasizes the following:[95]

- Understanding and Fulfilling Ethical Requirements: The standard specifies that the firm and its personnel must understand and fulfill their responsibilities concerning the relevant ethical requirements applicable to the firm and its engagements. This includes ensuring that everyone, including the network and service providers, subject to these ethical standards, understands and complies with them.
- Ethical Requirements in Quality Objectives: ISQM 1 requires that the quality objectives established by the firm must address the fulfillment of responsibilities in accordance with relevant ethical requirements. This includes ethical standards related to independence, which must be understood and followed by the firm's personnel and others, including the network, network firms, individuals in the network or network firms, or service providers .
- Ethical Considerations in Client Relationships: When deciding whether to accept or continue a client relationship or specific engagement, the firm must consider the client's integrity and ethical values. This evaluation is part of the firm's quality objectives and is essential for maintaining ethical standards throughout engagements.
- Dealing with Breaches of Ethical Requirements: ISQM 1 outlines how a firm should handle breaches of ethical requirements. It includes policies for identifying, communicating, evaluating, and reporting breaches and requires timely actions to address the consequences of such breaches.

[94] ISQM 1, Governance and Leadership, Paragraph 28.
[95] Paragraph 29 Relevant Ethical Requirements

APPENDIX SIX

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APPENDIX SEVEN

List of Stakeholders Outreach

#	Abbrev.	Stakeholder	Region
Regulators and Oversight Authorities, Including MG members			
1.	ACRA	Accounting and Corporate Regulatory Authority (Singapore)	Asia Pacific (AP)
2.	AOB	Malaysian Oversight Board	AP
3.	APRA	Australian Prudential Regulation Authority	AP
4.	ASIC	Australian Securities and Investments Commission	AP
5.	AU ATO	Australian Tax Office	AP
6.	AU FRC	Australian Financial Reporting Council	AP
7.	CEAOB[96]	Committee of European Auditing Oversight Bodies	Europe (EU)
8.	CPAB	Canadian Public Accountability Board	North America (NA)
9.	CyPAOB	Cyprus Public Audit Oversight Board	EU
10.	IFIAR SWG	International Forum of Independent Audit Regulators Standards Coordination Working Group	GLOBAL
11.	IOSCO	International Organization of Securities Commissions C1 Committee	GLOBAL
12.	JFSA	Japan Financial Services Agency	AP
13.	MG	Monitoring Group Chair	GLOBAL
14.	OECD	Organization for Economic Cooperation and Development	GLOBAL
15.	OSC	Ontario Securities Commission	NA
16.	PHSEC	Securities and Exchange Commission (Philippines SEC)	AP
17.	PPPK	Center for Supervision of the Financial Service Profession (Indonesia)	AP
18.	THSEC	Securities and Exchange Commission (Thailand SEC)	AP
19.	UK FRC	United Kingdom Financial Reporting Council	UK
20.	US SEC	US Securities and Exchange Commission	US
Investors and Other Users			
21.	ICGN	International Corporate Governance Network	GLOBAL

[96] CEAOB represents auditing oversight bodies in all 27 EU member states.

#	Abbrev.	Stakeholder	Region
Preparers and Those Charged with Governance			
22.	DFCG	Association Nationale des Directeurs Financiers et de Contrôleur de Gestion	EU
23.	ICFOA	International Chief Financial Officers Association	GLOBAL
24.	IoD Kenya	Institute of Directors Kenya	Middle East and Africa (MEA)
25.		M P Vijay Kumar	AP
26.		Mr. Manoj Fadnis	AP
Independent[97] National Standard Setters			
27.	AUASB	Australian Auditing and Assurance Standards Board	AP
Professional Accountancy Organizations (PAOs)[98]			
28.	ACCA	Association of Chartered Certified Accountants	GLOBAL
29.	AE	Accountancy Europe	EU
30.	ICAEW	Institute of Chartered Accountants in England and Wales	EU
31.	ISCA	Institute of Singapore Chartered Accountants	AP
Accounting Firms and Sole Practitioners			
32.	DTTL	Deloitte Touche Tohmatsu Limited	GLOBAL
33.	EY	Ernst & Young Global Limited	GLOBAL
34.	GTIL	Grant Thornton International Limited	GLOBAL
35.	KPMG	KPMG International Limited	GLOBAL
36.	PwC	PricewaterhouseCoopers International Limited	GLOBAL
Academia and Research Institutes			
37.	NUS	National University of Singapore	AP
Others			
38.	FoF	Forum of Firms[99]	GLOBAL
39.	IFAC CoP	IFAC International Standards Community of Practice	GLOBAL
40.	IFAC SMPAG	IFAC Small and Medium Practices Advisory Group	GLOBAL
41.	INEs	Independent Non-Executives	UK and Global
42.	NSS	National Standard Setters[100]	GLOBAL
43.	SAC	Stakeholder Advisory Council[101]	GLOBAL

[97] NSS that have the mandate to set national ethics standards, including independence requirements, in their jurisdictions and which do not belong to PAOs are categorized as "Independent National Standard Setters."

[98] For purposes of this categorization, a PAO is a member organization of professional accountants, of firms, or of other PAOs. PAOs include but are not limited to IFAC member bodies.

[99] The Forum of Firms is an association of international networks of accounting firms that perform transnational audits. Members of the Forum have committed to adhere to and promote the consistent application of high-quality audit practices worldwide and use the ISAs as the basis for their audit methodologies. They also have policies and methodologies for the conduct of such audits that are based to the extent practicable on and use the International Standards on Auditing (ISAs), and policies and methodologies that conform to the IESBA Code and national codes of ethics as the basis for their audit methodologies.

[100] The meeting participants are from Australia, Canada, China, France, Germany, Hong Kong SAR, India, Japan, the Netherlands, New Zealand, South Africa, the United Kingdom and the United States.

[101] The Stakeholder Advisory Council (SAC) provides strategic input and recommendations to the International Auditing and Assurance Standards Board (IAASB) and IESBA. It is a forum for the IAASB and IESBA to engage with diverse external stakeholders, thereby drawing on additional expertise and experience for their standard-setting projects.

APPENDIX EIGHT

Examples of Ethical Failures Within Firms

Below are some examples of scandals affecting firms where regulators have reported ethical lapses.

Carillion and KPMG (2018):

The United Kingdom Financial Reporting Council (UK FRC) announced sanctions against KPMG LLP (KPMG), a former KPMG partner, and four former KPMG employees following an investigation undertaken pursuant to the Accountancy Scheme. The investigation related to the provision of false and misleading information and documents to the UK FRC in connection with the UK FRC's Audit Quality Reviews of two audits carried out by KPMG: the audit of the financial statements of Regenersis plc for the period ended 30 June 2014 ("the Regenersis audit"); and the audit of the financial statements of Carillion plc for the period ended 31 December 2016 ("the Carillion audit").

Findings of Misconduct

The allegations in the Formal Complaint related to the FRC inspections (known as Audit Quality Reviews, or AQRs) of the Carillion and Regenersis audits. The allegations concerned the provision of false and misleading documents and information to the AQR teams. The Formal Complaint did not allege Misconduct arising from the performance of the relevant audits, nor did it allege that, in either case, the financial statements had not been properly prepared.

The Tribunal made a number of findings of Misconduct involving breaches of the fundamental principle of Integrity which requires an accountant to be straightforward and honest in all professional and business relationships, stating:

No accountant should require any education or training to realise that deliberately misleading anyone, but especially a regulator, is at least incompatible with integrity and, barring special circumstances, dishonest.

KPMG (2019):

The U.S. Securities and Exchange Commission (US SEC) charged KPMG LLP with altering past audit work after receiving stolen information about inspections of the firm that would be conducted by the Public Company Accounting Oversight Board (PCAOB). The SEC's order also finds that numerous KPMG audit professionals cheated on internal training exams by improperly sharing answers and manipulating test results.

KPMG agreed to settle the charges by paying a $50 million penalty and complying with a detailed set of undertakings, including retaining an independent consultant to review and assess the firm's ethics and integrity controls and its compliance with various undertakings.

Exam Cheating Scandals (2022 – 2024)

The US SEC charged Ernst & Young LLP (EY) for 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. The Order finds that EY violated a Public Company Accounting Oversight Board (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. (June 2022)

The Public Company Accounting Oversight Board (PCAOB) sanctioned PwC China and PwC Hong Kong for violating PCAOB quality control standards related to integrity and personnel management. Both firms failed to detect or prevent extensive, improper answer sharing on tests for mandatory internal training courses. From 2018 until 2020, over 1,000 individuals from PwC Hong Kong and hundreds of individuals from PwC China engaged in improper answer sharing – by either providing or receiving access to answers through two unauthorized software applications – in connection with online tests for mandatory internal training courses related to the firms' U.S. auditing curriculum. (November 30, 2023)

The PCAOB announced two settled disciplinary orders sanctioning KPMG Accountants N.V. ("KPMG Netherlands") and its former Head of Assurance, for violations of PCAOB rules and quality control standards relating to the firm's internal training program and monitoring of its system of quality control. The PCAOB found that widespread improper answer-sharing occurred at the firm over five years and that the firm made multiple misrepresentations to the PCAOB about its knowledge of the misconduct (April 2024)

The PCAOB announced three settled disciplinary orders sanctioning Imelda & Raken ("Deloitte Indonesia"), Navarro Amper & Co. ("Deloitte Philippines"), and the latter's former National Professional Practice Director, for violations of PCAOB rules and quality control standards relating to the firms' internal training programs and monitoring of their systems of quality control. (April 2024)

PwC Australia (2023)

The scandal highlighted severe governance and cultural failures within the firm, characterized by breaches of confidentiality and a lack of accountability.

This breach of trust led to significant consequences: the resignation of the CEO, the 'exiting' of eight senior partners, the sale of PwC's government business, the launch of several Senate Inquiries[102], and ongoing investigations by the Australian Federal Police and the Tax Practitioners Board. (https://www.afr.com/topic/pwc-tax-scandal-6g22)

On 22 June 2023, the Australian Parliament's Parliamentary Joint Committee on Corporations and Financial Services (PJC) launched an inquiry into recent allegations of and responses to misconduct in the Australian operations of the major accounting, audit, and consultancy firms (including but not exclusive to the Big Four firms). The inquiry was launched in response to the revelation of misconduct within the sector, including the misuse of confidential Australian Government information by partners and employees of the multidisciplinary firm PwC Australia. The PJC presented its final report with 40 recommendations in November 2024.

[102] The Senate released the first report in June 2023 and the second report in March 2024. The WG also noted an ongoing consultation by The Treasury in Australia (May 2024) titled Regulation of Accounting, Auditing, and Consulting Firms. This initiative explores the regulatory framework for these firms, seeking to enhance governance, transparency, and accountability. It addresses issues such as the adequacy of current governance practices, professional standards, and regulatory laws. The paper also considers the protection of whistleblowers, the resilience of the audit sector, and competition within the industry.

APPENDIX NINE

Standard-Setting Project – Illustrative Examples

The following are illustrative examples of requirements and application material in the areas of firm-wide culture and governance framework that might be incorporated into a new standard in the Code that addresses the topic of firm culture and governance.

A firm-wide governance framework

> ***A firm shall ensure its governance framework promotes high standards of ethical behavior by prioritizing and embedding ethical values in its strategies, operating structures, quality management systems and accountability mechanisms.***

The supporting application material might:

- Emphasize that the Code applies to all partners and staff of the firm (including, where jurisdictions have established conflicting or different provisions, the obligation to observe the more stringent provisions unless prohibited by law or regulation[103]).
- Emphasize that "firm" includes all firms within the network that meet the Code's definition of "network firm".
- Recommend the matters to be addressed in the culture and governance framework, including:
  - The roles and responsibilities of individuals in leadership positions.
  - The development of a framework/policies and procedures to implement and promote the ethical principles established by the Code.
  - The importance of transparency to demonstrate, both internally and externally (including to regulators), compliance with the governance framework.
- Emphasize that with leadership and authority comes accountability.
- Recognize that there is no 'one-size fits all' model and that the steps to be taken should reflect matters such as a firm's size, geographic location(s) and practice areas.
- [Others]

103 See Paragraph 100.7 A1

Provision of Independent Input

A firm that [describe criteria] shall consider appropriate means of obtaining input from independent persons to contribute to the effectiveness of the firm's governance framework to promote ethical values and to monitor its compliance with the [FCG provisions].

The supporting application material might:

- Recommend that the responsibilities assigned to such INEs or other independent persons include some or all of the following:
  - Reviewing compliance with the [FCG provisions], ethical standards, and relevant laws and regulations (including its regional and network firms).
  - Monitoring the leadership team's actions and decisions to ensure that they comply with and promote the policies and procedures established by the firm to implement and promote the ethical principles established by the Code.
  - Providing strategic input to key decisions by contributing diverse perspectives and expertise.
  - Providing input into the process for the appointment of the CEO (or equivalent) and other senior leadership roles within the firm.
  - Providing input in regular evaluations of the CEO and senior management and assessing their performance against the [FCG provisions], ethical standards, and relevant laws and regulations.
- Establish the process by which INEs are appointed to ensure their independence and ensure there is the right mix of skills, knowledge, and experience.
- [Others]

Performance management policies that incentivize ethical behavior

Firms shall establish criteria by which the performance of the partners and staff of the firm are evaluated and rewarded that recognize the importance of compliance with ethical standards and adherence to the firm's ethical values and policies.

The supporting application material might:

- Highlight the importance of aligning performance evaluation criteria with the expected ethical values of the firm.
- Provide examples of performance metrics that might be used to evaluate an individual's approach to compliance with the firm's ethical values and policies.
- [Others]

Education and training programs

Firms shall provide continuous education and training on ethical standards and policies, professional and regulatory obligations, and the ethical values and behaviors expected of all partners and staff of the firm.

The supporting application material might:

- Address the importance of educating new partners and staff of the ethical values of the Firm and expected behaviour when they first join the firm.
- Emphasize the importance of developing an ethical mindset.
- Highlight the importance of regular, continuing education and training to ensure that the firm's policies remain 'front of mind'.
- [Others]

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