

Meeting: IESBA

Meeting Location: New York

Meeting Date: September 16-20, 2024

Agenda Item 5

Firm Culture and Governance

Objectives of Agenda Item

1. To consider:
 - (a) An update from the Firm Culture and Governance (FCG) Working Group¹ on its recent outreaches and fact-finding activities.
 - (b) The Working Group's preliminary report.

Working Group Activities

2. As part of its information gathering, the Working Group conducted a series of outreach activities in Q3 2024, including several in-person meetings in London, United Kingdom. Please refer to **Appendix 2 of Agenda Item 5-A** for a list of the stakeholders.
3. The Working Group met in person in July and via teleconference in August 2024 to develop the agenda materials.

September 2024 IESBA Meeting

4. At the September 2024 IESBA meeting, the Working Group will provide:
 - An update of its outreach activities in Q3.
 - An overview of the Working Group's preliminary report including its preliminary views and recommendations (See **Agenda Item 5-A**).

¹ The Working Group consists of the following IESBA members:

- Channa Wijesinghe, Chair of Working Group
- Rich Huesken
- Héctor J. Lehuedé
- Rania Uwaydah Mardini

It is also supported by:

IESBA STAFF

- Geoffrey Kwan
- Carla Vijian

CONSULTANT

- Richard Fleck

Next Steps

5. The Working Group will continue its stakeholder engagement activities in Q4.
6. Subject to feedback from the Board at this meeting, the Working Group intends to present a final report at the December 2024 IESBA meeting.

Actions Requested

7. The IESBA members are asked to provide their feedback on the FCGWG's preliminary views and recommendations as set out in Sections VIII and IX Preliminary Report in **Agenda Item 5-A**.

Material Presented

For discussion:

Agenda Item 5-A Firm Culture and Governance Working Group Preliminary Report

FIRM CULTURE AND GOVERNANCE

PRELIMINARY REPORT

SEPTEMBER 2024

**IESBA
FIRM CULTURE AND GOVERNANCE
WORKING GROUP**

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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,¹ the United Kingdom, the Netherlands and Australia,² 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 squarely 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 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-person³ and virtual meetings with all categories of stakeholders, including regulators, standard-setters and global and national leaders of firms⁴ and has commissioned academic research. The insights and findings collected from these extensive and diversified outreach initiatives have already been subject to preliminary discussions with the IESBA

¹ For example, in the United States, 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.

² Refer to Appendix Three of this report for further details.

³ Members of the Working Group held in-person outreach meetings in Toronto, Tokyo, Singapore, New York, Sydney, Melbourne and London and met with a diverse group of stakeholders. Refer to Appendix Two for further details.

⁴ Members of the Working Group held a total of 40 in-person and virtual meetings between Q1 and Q3 2024 including 12 meetings with the regulators and 10 meetings with firm representatives from various jurisdictions. Refer to Appendix Two for the list of stakeholders consulted.

Board and its leadership, as well as the Public Interest Oversight Board and other institutional stakeholders. The report already 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 (namely, as evidenced by recent events in Australia, South Africa, the Netherlands, the United Kingdom, and the United States).
- 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 deficiencies in the relevant firm's ethical culture.
- A strong ethical culture, supported by ethical leadership and an effective governance framework at a firm-wide level, 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 also impact how firms nurture their ethical culture.

6. In the course of its research, the FCGWG has identified key elements that create and underpin a culture where ethical values are embedded in every aspect of a firm's strategy and operations, from business growth to decision-making processes and daily interactions among employees. Those key elements focus mainly on a firm's leadership and governance framework and include:

- Leaders who prioritize ethical values and behavior as the foundation of the firm's ethical culture, embedding those values in the firm's governance, policies and practices, and who, by their conduct, exemplify that culture.
- A strong 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.
- The provision of input by independent individuals (such as independent non-executives) 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 where open dialogue, consultation and challenge, including a speak-up culture, are encouraged.
- The provision of increased education and training on ethical standards and policies throughout the careers of partners and staff of the firm.

The FCGWG's Recommendations

7. 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 the key attributes (refer to paragraph 8) of an ethical firm. The new provisions should be principles-based, scalable and applicable across all service lines of the firm.
 - (b) The development of NAM to:
 - Demonstrate the impact of ethical culture in driving ethical behavior within firms and the principal factors that contribute to a strong ethical culture and
 - Highlight the contribution from various stakeholders to promote and support, on an ongoing basis, highly ethical behavior within accounting firms, individually and collectively.
8. The objective of both these work streams should be to establish a global baseline for how firms can establish and maintain a firm-wide ethical culture, addressing the importance of:
 - (a) Leaders committed to and responsible for the promotion and monitoring of ethical values and behavior within the firm.
 - (b) An effective firm-wide governance framework that supports ethical behavior.
 - (c) Independent Non-Executives.
 - (d) Performance management policies that incentivize ethical behavior, including rewards and recognition.
 - (e) Being transparent to regulators and other stakeholders about its ethical performance.
 - (f) Policies and procedures to promote and facilitate consultation and challenge.
 - (g) Education and training programs.
 - (h) Policies and procedures to monitor ethical behavior.

II. INTRODUCTION

Background

9. The accountancy profession has been facing high-profile incidents of unethical behavior in firms relating to both their audit and consulting services. Notably, some recent cases involving professional accountants in public practice (PAPPs) have led to major sanctions, multi-million-dollar penalties and other adverse consequences for individual PAPPs and their firms in multiple jurisdictions. This is a critical challenge for the profession.
10. In response to these issues, the IESBA released a public [statement](#) in July 2023 emphasizing the vital importance of ethical behavior for all PAs and reminding them of their ethical obligations under the Code. These obligations include upholding the fundamental principles of the IESBA Code⁵ (the Code) and complying with its specific requirements, which enable PAs to meet their responsibility to act in the public interest.⁶
11. The IESBA is of the view that the persistence of unethical behavior in firms calls into question their culture and governance and how it 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. This issue goes to the core of the profession's vibrancy and longer-term sustainability, which includes talent attraction and retention.
12. Recognizing the significant public interest implications of unethical behavior in the profession and the IESBA's responsibilities as a global ethics standards-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

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,⁷ 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;
 - (c) Raise awareness of the issues relating to and the importance of governance and ethical culture within firms through outreach activities and

⁵ [International Code of Ethics for Professional Accountants \(including International Independence Standards\) \(the Code\)](#)

⁶ 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).

⁷ Refer to the FCGWG's approved [Terms of Reference](#).

- (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 2024⁸ that included a series of stakeholder meetings and interviews, both in person and virtually, allowing for engagement with a wide range of stakeholders. These outreaches included consultations with the Standard Setting Boards' Stakeholder Advisory Council (SAC)⁹ in April 2024 and the IESBA National Standard Setters (NSS)¹⁰ group in May 2024.
 - 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 \(ISQM 1\)](#). As part of this examination, the FCGWG also held discussions with representations from the United Kingdom Financial Reporting Council (UK FRC), Japan Financial Services Agency (JFSA), and IAASB to understand these frameworks further.¹¹
 - Undertook additional literature reviews and other desktop research.
15. In forming its preliminary views (Section VIII), the FCGWG considered the information received from its information-gathering activities, input received from the Board and the Public Interest Oversight Board (PIOB), and its analysis of the Code's existing provisions on the topic.
16. To reach its recommendations (Section IX), 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 provides a summary of the feedback received from stakeholders by key themes, including key comments by stakeholder groups.
 - Section IV provides a summary of the academic report, synthesizing global research on culture and governance relevant to the narrower IESBA topic of firm culture and governance.
 - Sections V to VII focus on relevant provisions in the extant Code, jurisdictional audit firm governance codes, and ISQM 1.

⁸ Refer to Appendix Two 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.

¹¹ The FCGWG examined two existing Audit Firm Governance Codes (see Section VI) and the IAASB's ISQM 1 (see Section VII).

- Section VIII presents the FCGWG's preliminary views, which include the public interest issues, and sets the stage for understanding the context and rationale behind the Working Group's recommendations.
- Section IX outlines the FCGWG's recommendations and proposed timeline.

III. SUMMARY OF STAKEHOLDER OUTREACH FEEDBACK

18. The FCGWG conducted an extensive outreach program throughout 2024¹², which facilitated a broad engagement with various global and jurisdictional stakeholder groups, including regulators, firms, and in certain instances, their independent non-executives (INEs), professional accountancy organizations, finance executives, investors and those charged with governance communities. The FCGWG also obtained feedback at the SAC and NSS meetings held in April and May 2024. These meetings were held virtually and in person (in Toronto, Tokyo, Singapore, New York, Sydney, Melbourne and London).
19. 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. The remainder of this Section delves into these themes as shared by stakeholders, highlighting the relationship between firm governance, its leadership, and the resulting culture and how they may be shaping ethical behavior within firms. While the FCGWG received a broad range of input from stakeholders, it is anticipated that it will continue its information-gathering efforts till the end of this year, and there will be further engagement with stakeholders if and when the workstream moves into the standard-setting phase.

Role of the Profession and Public Interest

20. Stakeholders universally recognize that firms and professional accountants (PAs) have a responsibility to act in the public interest and maintain public trust.¹³ Acting in the public interest is crucial for PAs because their work may impact the economy, investors, 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.¹⁴
21. 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 ethical dilemmas.
22. Moreover, stakeholders emphasized the delicate balance that firms must navigate between pursuing revenue growth and fulfilling their public interest responsibilities.¹⁵ 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 revealed that ethical dilemmas often arise from pressure to achieve key performance indicators (KPIs).¹⁶ These pressures may lead to compromising

¹² Refer to Appendix Two for the list of stakeholders consulted.

¹³ Paragraph 100.1 of the 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.

¹⁴ <https://www.sec.gov/newsroom/speeches-statements/munter-20220608>

¹⁵ Regulators, SAC, NSS, Professional Accountancy Organizations (PAOs)

¹⁶ Regulators, NSS, Firms, PAOs

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 reputation, the profession's reputation, and the broader public interest.¹⁷

Role of Leadership

23. 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.¹⁸ This concept, often referred to as "tone at the top,"¹⁹ 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.²⁰
24. 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. 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.²¹

Accountability of Leadership

25. In the same vein, stakeholders²² agreed that firm leaders bear significant responsibility for maintaining ethical standards. Accountability mechanisms, such as appointing dedicated ethics leaders,²³ regular performance reviews, and comprehensive compliance reporting, help to ensure that all employees, particularly those in leadership positions, are held accountable for their actions and that deviations from ethical standards are promptly addressed.
26. 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 firm. 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

¹⁷ Switkowski Report (2023) (<https://www.pwc.com.au/about-us/commitments-to-change/independent-review-of-governance-culture-and-accountability-at-pwc-australia.pdf>)

¹⁸ Regulators, SAC, NSS, Firms, PAOs, Those Charged with Governance

¹⁹ "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)

²⁰ 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. The "tone at the top" refers to the ethical climate and culture established by an organization's senior management.

²¹ Regulators, SAC, NSS, Firms, PAOs

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

²³ OSC Staff Notice 52-724 - [Considerations for Public Accounting Firms in Developing Internal Ethics Policies and Procedures in Developing Internal Ethics Policies and Procedures](#) (June 2023)

global ethical policies and practices, creating a cohesive organizational culture where ethical behavior is consistently prioritized and reinforced at all levels.²⁴

27. Representatives from the larger firms have explained to the FCGWG that their leaders, whether at the global or local level, 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.

Governance Framework

28. 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.
29. 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.²⁵ In this regard, some stakeholders²⁶ have suggested that the reporting, accountability and other governance requirements of partnerships may be less stringent than those for public companies.^{27 28}

²⁴ 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.

²⁵ 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>).

²⁶ NSS, Investors

²⁷ In this [report](#), it states that LLPs are not required to submit audited financial statements but instead report based on their partnership agreements. This reduces transparency and accountability and the report states that the LLP structure contributes to the systemic issues within the audit industry, where partners benefit from high rewards without proportional risks, leading to poor audit quality and insufficient accountability.

²⁸ 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.

Independent Non-Executives (INEs)

30. Stakeholders highlighted that in certain jurisdictions, firms' governance has been strengthened by the introduction of INEs.²⁹ INEs provide independent input to a firm's decision-making process through the lens of public interest.
31. The [UK FRC Audit Firm Governance Code \(April 2022\)](#)³⁰ (UK AFGC, UK Code) requires the appointment of INEs to a firm's governance structure. Discussions with stakeholders³¹ in the UK revealed 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. Firms³² exemplify this process by implementing thorough vetting procedures to ensure that INEs possess the necessary expertise, independence, and integrity. 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.
32. The UK AFGC also requires the appointment of audit non-executives (ANEs) when a firm has established an Audit Board when applying the UK FRC's Principles for Operational Separation. Under the UK FRC Audit Firm Governance Code³³, the Audit Board is responsible for providing independent oversight of a firm's audit practice with a focus on improving audit quality.
33. In Japan, firms have 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 in implementing best practices in governance and benchmarking their governance practices against international standards.³⁴
34. 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.³⁵

²⁹ In the United Kingdom and Japan, there are audit firm governance codes that mandate the responsibilities of Independent Non-Executives (INEs) and Audit Non-Executives (ANEs) in firms.

³⁰ The UK FRC encourages all such firms to adopt this Code voluntarily and expects firms to apply it once they audit 20 or more PIEs or if they audit one or more FTSE 350 companies. Where the number of PIE audits conducted by a firm applying this Code drops below 10 and a firm does not audit any FTSE 350 companies, it may cease to apply this Code. Firms that do not meet these thresholds and who apply the Code, may choose to apply it in a manner proportionate to their size and the nature of the entities they audit.

³¹ Regulators, INEs

³² [Ernst and Young UK Transparency Report 2023](#), [Deloitte UK Transparency Report 2023](#), [KPMG UK Transparency Report 2023](#) and [PwC UK Transparency Report 2023](#)

³³ [Part D](#) of UK Audit Firm Governance Code (D INEs and ANEs).

³⁴ 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.

³⁵ For example, [PwC](#) and [KPMG](#) Australia announced the appointments of independent directors to its Board.

Network

35. As firms expand and integrate geographically, they encounter diverse cultural norms and practices, which can complicate efforts to uphold consistent ethical standards across their networks.³⁶ 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.³⁷ Mechanisms to hold global and local leadership accountable for network failures are essential for maintaining consistency and integrity across global operations.
36. The growth of multi-disciplinary firms,³⁸ which often operate as networks and affiliates, also raises concerns about the adequacy of penalties for breaches of ethical conduct.³⁹ Stakeholders called for accountability mechanisms within these networks to ensure compliance with ethical and professional standards.
37. Through discussions with representatives from firms and professional accountancy organizations (PAOs), the FCGWG was informed that implementing a global baseline of ethical culture (a uniform set of ethical standards and practices across all network firms) faces significant challenges. These include 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

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

Rewards and Recognition

39. Stakeholders⁴⁰ 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 with ethical behavior, firms can create an environment where employees are driven to act ethically.

³⁶ [Firm Culture and Governance](#)

³⁷ 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.

³⁸ Over the past decade, the consulting arms of accounting firms have witnessed exponential growth, significantly outpacing their traditional audit practices.

³⁹ Regulators, Firms, PAOs

⁴⁰ Regulators, SAC, Firms, PAOs

40. Therefore, stakeholders expressed the need for firms to carefully design their incentive structures, recognizing that poorly designed incentives can lead to unintended consequences.⁴¹ One stakeholder has particularly observed⁴² that while there are strong incentive structures for certain behaviors, the disincentive structures (penalties or negative consequences) for unethical behavior are often weak.
41. Firm representatives have all 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.⁴³ These firms 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

42. Firms are increasingly encouraged to implement transparent reporting mechanisms to provide stakeholders with clear views of their operations and ethical performance.⁴⁴ For example, in the United Kingdom, the UKAFGC 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)⁴⁵ and Australia,⁴⁶ 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.
43. 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,⁴⁷ detailed disclosures about how firms manage ethical risks and ensure compliance with ethical

⁴¹ 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.’

⁴² Regulator

⁴³ Regulators, SAC, Firms, PAOs

⁴⁴ Regulators, SAC, Firms

⁴⁵ European statutory audit regulations ([Article 13](#) of Regulation (EU) 537/2014)

⁴⁶ Section 332 of the Corporations Act (<https://asic.gov.au/regulatory-resources/financial-reporting-and-audit/auditors/audit-transparency-reports/>)

⁴⁷ SAC, TCWG

standards help maintain ethical standards and accountability and inform stakeholders about a firm's commitment to ethics.

Education and Training

44. Another important element that helps instill an ethical culture within firms is education.⁴⁸ 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 staff members understand and appreciate the importance of ethical behavior. This becomes even more critical in light of recent cheating scandals within firms,⁴⁹ which have severely impacted their reputations and trustworthiness. These scandals highlight the importance of firm leadership in preventing such incidents from recurring.⁵⁰
45. In discussing with the firms, the FCGWG was informed that firms carry out firm-wide annual or bi-annual ethics training to ensure that every employee, regardless of their position, understands the significance of ethics. This approach helps in creating a unified understanding and commitment to ethical standards across the firm.
46. The growth of consulting services in firms necessitates a rigorous process to ensure that personnel are appropriately onboarded.⁵¹ 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 of Ethics and applicable professional standards. This lack of familiarity with the Code complicates the enforcement of compliance with firms' ethical obligations. Some stakeholders have also suggested that staff turnover necessitates ongoing professional training.
47. Stakeholders stressed the need for robust education and training programs to keep professional accountants updated with the latest ethical standards.⁵² Firms are increasing their education efforts, particularly for those parts of the firm that are not involved in the audit business line.⁵³ Stakeholders believed that all players in the ecosystem⁵⁴ 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), which critiqued the inadequacies of the current university curriculum in ethics education. They advocate for a comprehensive overhaul of accounting education to include robust ethics training,⁵⁵

⁴⁸ Regulators, SAC, NSS, Firms, PAOs, Those Charged with Governance

⁴⁹ Cheating scandals have involved the Big Four firms spanning from 2019 to 2024. Refer to Appendix Three.

⁵⁰ 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.

⁵¹ Firms

⁵² PAOs

⁵³ Firms

⁵⁴ Other players in the ecosystem, such as the regulators and PAOs.

⁵⁵ The authors identify 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.

emphasizing the need for educational institutions and professional bodies to work together to foster a culture of ethics.

Culture of Consultation and Challenge

48. 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 consultation 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. This environment ensures that potential ethical issues are identified and addressed promptly, upholding high ethical standards within the organization.
49. 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 employees⁵⁸ did not feel safe to raise concerns due to fear of retribution or negative consequences.
50. Stakeholders⁵⁹ 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.
51. A healthy culture of consultation 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.
52. Discussions with stakeholders also noted that culture surveys and assessments are tools for gauging the effectiveness of ethical practices, employee engagement, and overall satisfaction within the firm.

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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.

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.

Trends in Accounting Firms

Growth of Consulting Services

53. A study⁶¹ that analyzed Big Four firms' expansion into consulting services from 2007 to 2015 postulated that regulators worry that the focus on growing consulting practices may lead the Big Four firms to prioritize consulting over auditing, potentially compromising audit quality. This shift in focus could lead to a cultural transformation within firms from an audit-centric mindset to a consulting-centric one, characterized by a focus on client advocacy. The study found that consulting services related to auditing (e.g., data analytics) can enhance audit quality by providing additional tools and expertise, and when it is unrelated to auditing, can distract audit partners and shift the firm's culture towards commercialism, leading to higher misstatement risks. The pursuit of maximizing revenue from consulting can sometimes occur at the expense of adherence to professional and ethical standards, thereby jeopardizing the firm's overall commitment to upholding ethical conduct.
54. 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.⁶² 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.^{63 64}
55. Certain consulting services, such as tax planning, insolvency, financial planning, and valuations, must comply with applicable 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 a widespread perception that the regulatory framework for non-audit services, particularly consulting,⁶⁵ 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.
56. In their book,⁶⁶ Mazzucato and Collington (2023) called for better oversight and regulation of the consulting industry. This includes stricter rules to ensure transparency in the contracts and relationships between consulting firms and their clients, especially in the public sector. Thus, while the expansion of consulting practices presents significant financial opportunities, it also poses substantial risks to the overall firm culture. The shift towards consulting may precipitate a cultural shift within firms, reducing the primacy of quality and understanding of the responsibility of the firm to act in the public interest. This potential erosion of trust underscores the necessity for a balanced

⁶¹ Imdieke, Andy, Donelson, Dain, Maksymov, Eldar, & Ege, Matthew. "The Revival of Large Consulting Practices at the Big 4 and Audit Quality." Harvard Law School Forum on Corporate Governance, 2020. Available at: [Harvard Law Forum](#).

62 <https://gusto.com/partner-resources/research-how-accounting-firms-are-evolving-2023>

⁶³ Refer to page 24 of the [report](#) which states that for the year 2023, the total combined % of revenue from non-audit services for non-audit clients were 79%.

⁶⁴ Refer to page 50 of the [report](#) from UK FRC which shows total fee income from non-audit clients from Big Four UK firms.

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

⁶⁶ Mazzucato, M., & Collington, R. (2023). *The Big Con: How the Consulting Industry Weakens Our Businesses, Infantilizes Our Governments, and Warps Our Economies*. Penguin Random House.

approach that emphasizes both revenue generation and the maintenance of rigorous quality and ethical standards.

57. 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.

Private Equity (PE) Investment in Firms

58. Private equity (PE) investment in firms involves the infusion of capital from PE firms into target firms,⁶⁷ often with the goal of restructuring, expanding, or enhancing the firm's value before eventually exiting through a sale or public offering. This type of 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.⁶⁸
59. However, this type of investment also comes with certain challenges⁶⁹ and requires careful consideration of a range of issues, such as a firm's ethical culture, auditor independence, and audit quality.⁷⁰ The involvement of PE firms often leads 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.
60. In the context of firms, PE investment may present unique challenges related to firm culture and governance. 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

⁶⁷ <https://www.ft.com/content/965e49a3-3ea7-46f2-9b74-e822788dcf72>

⁶⁸ https://www.journalofaccountancy.com/news/2024/jun/private-equity-has-big-plans-for-small-firms.html?utm_source=mn:cpal&utm_medium=email&utm_campaign=18Jun2024

⁶⁹ In this article, several [scenarios](#) were raised such as:

- Will audit staff be reduced on what many large firms consider the loss leading division of the firm to improve audit productivity?
- Will dropping unprofitable clients drive up the cost of audit services?
- Will raising fees increase the flight of public companies out of the regulatory system? One of the unintended consequences of Dodd-Frank and SOX was the acceleration of public companies out of the regulated financial system.
- Will there be reduced investment in auditing technology, AI software, and other tools that could enable audit firms to effectively compete against private equity-owned or managed accounting firms?
- Will private equity owners exert influence on the audit divisions to paint a better picture of a troubled client in which the private equity firm has a significant investment in order to avoid a restatement or lower earnings forecast?

⁷⁰ 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.

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.⁷¹

61. A report commissioned by the European Commission (DG Internal Market and Services)⁷² highlights several potential issues with PE ownership in audit firms. One key concern is the pressure on audit firms to maximize profits, which can lead to cost-cutting measures that affect audit quality. This may include reducing investment in staff training and technology and cutting back on resources necessary for quality audits or prioritizing high-margin clients over smaller, less profitable ones. Additionally, the governance changes brought by PE investors can impact the decision-making process within audit firms. PE investors often install their representatives on the firm's board, leading to a shift in strategic direction that may prioritize short-term financial performance over long-term professional excellence. This may create conflicts of interest and reduce the firm's ability to prioritize the quality of service delivery over short-term financial returns.

The Ecosystem

62. 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 necessitates collaboration with a diverse array of stakeholders, including regulators, standard setters, those charged with governance at clients or employers, investors, and professional associations. Such collaboration is essential not only for supporting ethical conduct but also for delivering high-quality work. Engaging with external parties provides firms with diverse perspectives, enhances their accountability, and reinforces their commitment to ethical standards.
63. For instance, the Australian Treasury's recent consultation paper⁷³ 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.
64. Effective monitoring and enforcement by regulators or professional accountancy associations (PAOs) are necessary to ensure firms' compliance with laws and ethical standards. Regulators and PAOs must have robust mechanisms in place to detect and address ethical breaches and non-compliance.⁷⁴ This includes regular inspections and the enforcement of stringent penalties for violations.⁷⁵

⁷¹ Paul Munter (August 2022) [Auditor Independence and Ethical Responsibilities: Critical Points to Consider When Contemplating an Audit Firm Restructuring](#).

⁷² [Ownership rules of audit firms and their consequences for audit market concentration](#) (Oxera, October 2007)

⁷³ [Regulation of accounting, auditing and consulting firms in Australia \(May 2024\)](#)

⁷⁴ Langenbucher, Katja & Leuz, Christian & Krahnert, Jan Pieter & Pelizzon, Lorian, 2020. "[What are the wider supervisory implications of the Wirecard case?](#)," SAFE White Paper Series 74, Leibniz Institute for Financial Research SAFE.

⁷⁵ <https://auditreformlab.group.shef.ac.uk/downloads/reward-for-failure.pdf>

65. Stakeholders have also highlighted that those charged with governance, investors and audit committees⁷⁶ play a vital 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.

IV. ACADEMIC RESEARCH

66. As part of its information gathering, the FCGWG engaged [Dr. Eva Tsahuridu](#) to prepare a report⁷⁷ 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 culture⁷⁸ is in shaping ethical behavior within firms.
67. 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
 - Governance structure and leadership are two key influencing factors of an organization's ethical culture.
68. Dr. Tsahuridu's analysis and findings are further summarized below.

What is "Culture"

69. A simple way to define culture is 'the way we do things around here.'⁷⁹ Schein (2010) 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.
70. 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-

⁷⁶ Investors, SAC

⁷⁷ Refer to [agenda item 2B – Academic Report by Dr. Eva Tsahuridu](#)

⁷⁸ Dr. Tsahuridu used Schein's (2010) three levels of cultural analysis—artifacts, espoused values, and underlying assumptions—to explain how to interpret both the visible and the profound, often unspoken beliefs that drive behavior.

⁷⁹ Deal, T. E., & Kennedy, A. A. (1982). Corporate cultures. Reading, MA: Addison-Wesley.

making in an organizational context”⁸⁰ or “how we do things around here in relation to ethics, a complex system that sends messages to employees that support or do not support ethical conduct.”⁸¹

71. 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.
72. Further, a number of studies identify a growing trend in accounting firms toward commercialism over public interest obligations. One study⁸² 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.

Key Factors that Influence Ethical Culture

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

Governance Framework

74. 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.⁸³ 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.
75. 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

76. Ethical leadership is the most examined antecedent of ethical culture⁸⁴ 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

⁸⁰ Roy et al., 2024. p. 99

⁸¹ Trevino et al. (2017)

⁸² Pierce (2007) - Page 3 of [agenda item 2B – Academic Report by Dr. Eva Tsahuridu](#). 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.

⁸³ Trevino et al. (1998)

⁸⁴ Brown & Trevino, 2006; Brown et al., 2005, Trevino et al., 2017

within the organization". Similarly, Schaubroeck et al. (2012) 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.

77. 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

78. 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.⁸⁵
79. 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."
80. Trevino and Brown (2004), suggest that individuals tend to conform to the expectations and behaviors of those around them, which Zimbardo (2005) more aptly puts as that "you cannot be a sweet cucumber in a vinegar barrel." Sharp-Paine (1994)⁸⁶ 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.
81. The FCGWG also noted in a separate literature review by Ashforth and Anand (2003) 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), 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.
82. 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.

⁸⁵ Kaptein (2011) ; Hiekkataipale & Lämsä (2019)

⁸⁶ Page 7 of [agenda item 2B – Academic Report by Dr. Eva Tsahuridu](#). Sharp-Paine (1994) noted that unethical practices typically involve the cooperation of multiple individuals rather than the flaws of a single actor.

V. RELEVANT PROVISIONS OF THE CODE

83. The extant Code contains a number of relevant provisions that emphasize the importance of upholding and maintaining the ethical conduct expected of PAs and an ethical culture within firms. These provisions outline the responsibilities and expectations placed on PAs and firm leadership to foster an environment where ethical principles are deeply integrated into the firm's operations and decision-making processes.

Part 1 of the Code

Sections 100 and 115

84. 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, PAs must also consider the interest of other stakeholders (paragraph 100.6 A4).⁸⁷
85. 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

86. 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.
87. 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.
88. 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 In the recent [Tax Planning pronouncements](#), 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

89. The Code recognizes that with higher positions, PAs wield more significant influence over the firm's policies, decisions, and actions (paragraphs 200.5 A3). Consequently, senior professional accountants 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.
90. Under the IESBA's Technology project, a similar provision has been added to Section 300 (paragraph 300.5 A2) and will become effective in December 2024.

Section 270

91. Paragraph 270.3 A3 of the 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.

VI. JURISDICTIONAL AUDIT FIRM GOVERNANCE CODES

92. 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 two jurisdictions. These codes apply to the leadership and governance structure of the whole firm and focus on promoting audit quality.
93. A key common feature among these codes is their focus on public interest and the firm's role in serving the public interest. Another key feature common to both codes is their primary purpose of promoting audit quality.

Scope and Applicability

94. The UK AFGC⁸⁸ applies to audit firms⁸⁹ 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.
95. Japan's Audit Firm Governance Code by the Council of Experts on the Audit Firm Governance Code (Japan AFGC, Japan Code)⁹⁰ 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 Certified Public Accountants Act.
96. Both AFGCs are applicable 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.

⁸⁸ 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.

⁸⁹ Although it is an Audit Firm Governance Code, the principles apply to the whole firm.

⁹⁰ 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

97. 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.
98. 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 person to enhance management effectiveness.

People and Culture

99. 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.
100. 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

101. 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 as well as the requirements of the AFGCs.
102. 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 owners. 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.
103. 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

104. 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.
105. 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.

VII. INTERNATIONAL STANDARD ON QUALITY MANAGEMENT 1 (ISQM 1)

106. 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 comply with professional standards and applicable legal and regulatory requirements. It also provides reasonable assurance that the reports issued by the firm or engagement partners are appropriate under the given circumstances.
107. SOQMs in compliance with ISQM 1 were required to be designed and implemented by December 15, 2022.
108. 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 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."⁹¹
109. 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.
110. 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.

Governance and Leadership

111. 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 self-regulates and serves as the framework for how the firm's decisions are made.
112. In accordance with ISQM 1⁹², the governance and leadership component of the SOQM establishes the quality objectives that establish the environment that supports the SOQM.
113. 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.

⁹¹ ISQM 1, paragraph A30

⁹² [ISQM 1, Governance and Leadership](#), Paragraph 28

114. 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

115. 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. Here are the specific mentions.⁹³
- 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.
116. 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 profession, regardless of the specific function or service line. A good ethical culture has a profound impact on the decision-making, behavior, and integrity of professionals across all areas of practice within a firm. Embedding these principles into the Code promotes a consistent ethical framework across all professional activities within the firm. This integration helps safeguard public trust in the profession by ensuring that ethical considerations are embedded in the firm's culture, influencing actions and decisions at every level.

⁹³ [Paragraph 29 Relevant Ethical Requirements](#)

VIII. WORKING GROUP PRELIMINARY VIEWS

Public Interest Issues

117. Accounting firms have cultivated a brand that commands public trust, underpinned by a longstanding reputation for professionalism and integrity. Central to this trust is the crucial role these firms play in the audit function, where they provide independent assurance on the reliability of financial statements—thereby fulfilling a vital public function. Auditors operate under a regulatory framework that mandates their duty to protect the public interest, which is foundational to their legitimacy and license to operate.
118. Although these firms have diversified their service offerings, expanding into multidisciplinary areas, and, in recent years, revenue growth from consulting services has significantly outpaced that derived from external audit services⁹⁴, it is imperative to recognize that their capacity to leverage the trust associated with their audit brand is intrinsically linked to the profession's responsibility to serve the public interest.
119. Audit and Consulting services are provided to both the private sector and the Government and other public sector entities. Where firms provide services that have industry or economy-wide effects or impact public services, they may be considered to be “systemically important entities.”⁹⁵
120. Although firms and the people in them strive to act ethically, unethical behavior occasionally occurs (as evidenced, for example, by recent high-profile events in Australia, the UK, the US, South Africa or the Netherlands, among other jurisdictions). The impact of unethical behavior can significantly tarnish the reputation of firms and networks and the quality and credibility of their work and have a major impact on the profession, society, and the economy. When such unethical behavior results in the delivery of poor-quality services that impact society, the public interest is adversely affected.
121. Such unethical behavior by individuals or groups may be attributable to leadership failures or weaknesses in whole-of-firm governance structure and processes. For instance, senior leadership may strongly drive to maximize revenue growth at the expense of adherence to ethical values, or there may not be an effective independent input within the governance structure to provide the necessary checks and balances from a public interest perspective. In some cases, the culture of the firm may not encourage employees or management to speak up when possible ethical or other issues are identified. Having an established speak-up culture (and the associated procedures) in place may prevent minor issues from becoming major failures and events.
122. To mitigate the risk of such ethical failures, it is essential to address not only ethical behavior at the individual level but also the broader organizational issues of ethical culture and governance, including leadership. These broader issues should be considered at a firm-wide level that covers all service lines.

Ethical Culture

123. Ethical culture reflects the shared values and beliefs of those within an organization about what constitutes appropriate behavior and decisions from an ethical perspective and is fundamental to a

⁹⁴ Refer to the [section](#) above discussing the growth of consulting services.

⁹⁵ Refer to [footnote 24](#) for an explanation of the term “systemically important” in the context of a firm.

firm upholding its ethical values and complying with its public interest obligations. Such a 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 that firm's ethical values and standards.

124. As highlighted in the Academic Report by Dr Eva Tsahuridu,⁹⁶ when a firm's culture embraces the ethical standards that all employees 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.⁹⁷
125. 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 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.
126. It is also important to recognize that leadership and governance are interconnected.
- Strong leadership is required to set the tone at the top and ensure the implementation and upholding of the Firm's ethical standards.
 - An effective governance structure is required to ensure that the leadership has the necessary ethical framework to guide its decisions and actions, be appropriately challenged, and be held accountable for its decisions and actions.
127. 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.
128. When all three – a strong ethical culture propelled by ethical leadership and effective governance – are present, quality of service delivery, the firm's reputation, client confidence and public trust are enhanced, and the risks arising from unethical behavior are mitigated.

Ethical Leadership

129. As firms expand their areas of practice geographically, the challenges of developing and ensuring effective accountability with a firm's governance framework increase.
130. While a firm's governance framework should have clear lines of accountability at all levels, leadership accountability is particularly crucial in promoting and maintaining an ethical culture within a growing and diverse firm. Leaders must demonstrate an unwavering commitment to ethical values and act in the public interest through their actions and decisions. Their behavior should consistently reflect the firm's values, serving as a model for all employees to follow.

⁹⁶ Refer to [agenda item 2B – Academic Report by Dr. Eva Tsahuridu](#)

⁹⁷ Refer to Appendix Three to sight scandals involving the Big Four firms spanning from 2019 to 2024 and the repercussions of breaches in ethical conduct.

131. In support, a firm's governance framework needs to have the necessary systems and controls in place to monitor and evaluate leaders' ethical conduct, the effectiveness of channels for reporting unethical behavior, and actions taken in response to breaches of ethical standards. This will enable leaders to be held accountable for ethical failures within the firm and network.

Governance Frameworks

132. A recurring theme during FCGWG's outreach was the importance that stakeholders attributed to the existence of a governance framework where all the key elements work effectively to drive the ethical culture of a firm, including, in particular, those discussed below.

Incentives and Rewards that align with Ethical Behavior

133. Firms must balance revenue generation with ethical behavior and their role in upholding the public interest. This requires, in particular, performance evaluations and rewards that promote a firm's commitment to ethics and integrity. When profit and ethics conflict, ethics should prevail.
134. By aligning incentives with ethical behavior, firms can create an environment where ethical considerations are integrated into all aspects of their policies, practices, decisions and work, management and employees are consistently encouraged to uphold high ethical standards (and penalized for failing to do so).

The importance of a culture of consultation and challenge.

135. A "speak-up" culture that encourages consultation, challenge and the identification of potentially problematic decisions or practices is an essential element of a firm's ethical environment and, importantly, mitigates the risk of unethical behavior.
136. To achieve such a culture, firms need to take a multifaceted approach:
- Firms must ensure that there are clear, accessible, and, where appropriate, confidential channels through which members of a firm can raise concerns and, if necessary, challenge decisions.
 - Management and employees should be reassured that their concerns will be taken seriously and handled with the utmost discretion.
 - Firms must 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 consultation and the firm's commitment to addressing unethical behavior and quality.

Continuous Education and Training

137. Training and education play a vital role in ensuring that all members of a firm, PAs and non-PAs alike, irrespective of business lines, understand and apply the firm's ethical standards and policies effectively in their daily activities.
138. Robust policies and procedures are required to ensure that both PAs and non-PAs continue to be aware of and adhere to ethical standards. Those policies and procedures should include continuing ethical education for all professionals, reinforced with the resources necessary to monitor compliance and enforcement.

Transparency about the firm's performance

139. A firm's commitment to its ethical values and leadership accountability is evidenced by its transparency about the ethically relevant aspects of the firm's performance. That 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 transparency on other matters such as financial performance, remuneration of key personnel, inducements, gifts and hospitality.
140. In addition, a firm's leadership should have an open and transparent dialogue on matters raised by the INEs in relation to its leadership, governance, and quality of service delivery.

The Provision of Independent Input

141. Stakeholders generally agreed that the provision of independent input, such as from INEs, contributes to the effectiveness of a firm's governance framework in promoting ethical values and culture 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.
 - (f) Risk Management - advising on how the firm identifies, assesses, and mitigates risks effectively safeguards the firm's assets and reputation.

Key Characteristics of an Ethical Firm

142. The FCGWG has reflected on the key characteristics of an “ethical firm” that transcend size, types of services provided and jurisdiction. In its view, an ethical firm is characterized by:
- An unwavering commitment to integrity, public interest, transparency, and accountability across all levels of the firm.
 - Senior leadership who are committed to putting ethics, trust and public interest as a top priority, demonstrated through their actions and decisions.

- A culture where ethical values are embedded in every aspect of the firm's strategy and operations, from business growth, decision-making processes related to the business itself and the internal management and organization, all the way down to strategic or daily interactions with and among employees, partners, suppliers and clients
- Partners and staff with knowledge of and true commitment to the relevant ethics standards.
- A holistic approach to the promotion of ethical behavior that includes robust governance framework(s), continuous ethical training, and clear, enforceable policies that promote ethical conduct.
- Regular assessments and quality reviews to measure and sustain the firm's ethical culture, identify areas for improvement, and reinforce positive behaviors.
- An environment that encourages open dialogue, critical mindset, questioning and challenging practices, continuous learning, and adherence to ethical principles.
- A commitment to regularly reviewing ethical policies to reflect evolving ethical challenges and professional standards. This includes integrating feedback from stakeholders, regulatory changes, and emerging best practices.

The Role of the IESBA Code

143. The dynamic and complex nature of the business environment presents significant challenges to the crafting of effective regulations. In such an environment, rigid regulations and rules-based approaches may fail to address the nuances and specific circumstances encountered in practice, necessitating a more adaptable approach.
144. Based on the FCGWG outreach to stakeholders⁹² and on the reflection and assessment undertaken, the FCGWG concluded that a principles-based approach could provide the necessary flexibility to apply different requirements, complemented by clear rules to ensure compliance and accountability. 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 adherence to ethical standards.
145. The FCGWG is of the view that, whilst it would not be appropriate for the IESBA Code to address matters relating to the legal structure of firms or attempt to prescribe the services they should or should not provide, the IESBA Code could be used as a platform to establish a global baseline that sets out a governance framework to be applied by firms across all jurisdictions in order to address the public interest issues highlighted above and to assist firms in building ethical cultures that will drive ethical behavior. As that framework would be principles-based, it would have the necessary flexibility to allow regulators or relevant local bodies to develop areas as they consider appropriate. Similarly, it would allow firms to customize their operations to take into account their particular circumstances or structures.
146. Likewise, a possible governance framework to support ethical behavior in accounting firms would benefit from existing governance frameworks for other types of entities and organizations, such as the OECD Corporate Governance Principles. It would build on the long experience gathered in that sector to develop principles and frameworks appropriate for accounting firms.
147. The extant Code 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 IESBA Code might be strengthened:

- The provisions relevant to firm culture and governance were added under different projects and are in different parts of the IESBA Code. This may make it difficult for users to gain a holistic view of how the IESBA Code addresses these issues. It would be more convenient if these provisions were in one section that addressed the issues relating to firm culture and governance at the firm level.
- Whilst Section 120 highlights 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 cover all the governance matters identified during the FCGWG's information gathering such as leadership accountability and rewards and recognition.
- The IESBA 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, should be expanded to cover a culture of consultation and challenge.
 - The IESBA Code could emphasize the need for firms to establish criteria or metrics that evaluate ethical performance or integrate ethical behavior into performance management systems.

The Ecosystem

148. 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. A holistic and integrated approach is required to ensure all players in the ecosystem work together, promoting ethical culture in firms in the public interest.

External Investment in Accounting Firms

149. The FCGWG received feedback from stakeholders regarding the potential implications of external investment in accounting firms. It noted the trend where some private equity firms propose to invest and, in some instances, have invested in firms.

150. The involvement of private equity firms is an important development. The typical private equity business model involves restructuring, expanding, or enhancing the firm's value before eventually exiting through a sale or public offering. This has the potential to significantly impact the ethical culture and governance of the firms involved. Such developments have started to attract the attention of regulators and the media.

151. The FCGWG concluded that:

- The IESBA Code and local ethics codes are applicable 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 IX)

152. The FCGWG, therefore, recommends that the implications of external investment be kept under review and subject to developments in the coming months and develop a final recommendation in this regard to IESBA by the end of Q4 of 2024.

IX. WORKING GROUP RECOMMENDATIONS

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

154. The FCGWG recommends that two work streams commence simultaneously in 2025 on the topic of Firm Culture and Governance:

- A standard-setting project to develop provisions to address firm culture and governance focusing on the key attributes (refer to paragraph 155) of an ethical firm. The new provisions should be principles-based and applicable across all service lines of the firm.
- The development of NAM to:
 - Demonstrate the impact of ethical culture in driving ethical behavior within firms and the principal factors that contribute to a strong ethical culture and
 - Highlight the required contribution from various stakeholders to promote and support, on an ongoing basis, highly ethical behavior within accounting firms, individually and collectively.

155. The objective of both these projects should be to establish a global baseline for how firms can establish and maintain a firm-wide ethical culture, 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 ethical behavior.
- (c) Independent Non-Executives.
- (d) Performance management policies that incentivize ethical behavior, including rewards and recognition.
- (e) Being transparent to regulators and other stakeholders about its ethical performance.
- (f) Policies and procedures to promote and facilitate consultation and challenge.
- (g) Education and training programs.
- (h) Procedures and procedures to monitor ethical behavior.

Standard-setting Project

156. The FCGWG recommends that the IESBA undertake a standard-setting project to develop provisions (FCG provisions) for inclusion in the Code that would promote the establishment of ethical cultures within firms supported by a robust governance framework and ethical leadership.
157. On the scope of the FCG provisions:
- The FCGWG proposes that the new FCG provisions should apply across all service lines of the firm, including all service lines.
 - These new provisions should be principles-based and allow firms the flexibility to develop their governance framework, recognizing that there is no one-size-fits-all model.
 - Further to discussions with the Small and Medium Practices (SMP) communities, these new provisions should be scalable as leadership and governance frameworks can vary significantly between a small practice to a large firm with a global network.
158. 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 in Parts 2 and 3 of 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.
159. To indicate how the project team might implement the FCGWG's recommended approach, the FCGWG has developed two illustrative examples of possible requirements and identified the application material that might support those requirements.⁹⁸ (see Appendix Four)

Non-Authoritative Material (NAM)

160. The FCGWG envisages that the purposes of the NAM would be to:
- (a) Explain the importance of ethical culture in driving ethical behavior within firms and the principal factors that contribute to a strong ethical culture and
 - (b) Describe the contribution that various stakeholders in the ecosystem can make to promote ethical behavior within accounting firms, individually and collectively.

The Way Forward

161. Subject to IESBA approval of the recommendations set out above, the FCGWG has considered how those recommendations might be taken forward.
162. As its recommendations contemplate two work streams that will need to be coordinated, the FCGWG recommends that a project team be established to oversee both work streams.
163. The FCGWG also recommends that the new project team undertake a global in-person public consultation or roundtable in Q1 and Q2 of 2025. Dialogues with stakeholders will help inform both work streams and will provide important feedback on matters such as, topics to be addressed in the

⁹⁸ It is important to emphasize that these are for illustrative purposes only.

NAM, the proposed scope and applicability of the new standard, as well as feedback on any preliminary or illustrative drafts.

164. The following is an illustrative timeline for both work streams:

Month	Action
2024	
December 2024	<ul style="list-style-type: none"> Approval of project proposal
2025	
Jan 2025	<ul style="list-style-type: none"> Release of Working Group Report and summary statement
March – April 2025	<ul style="list-style-type: none"> Global consultation – roundtables
June 2025	<ul style="list-style-type: none"> Feedback and Discussion of Global Roundtables
Sept 2025	<ul style="list-style-type: none"> First Read of Exposure Draft First Read of NAM
Dec 2025	<ul style="list-style-type: none"> Approval of Exposure Draft Approval of NAM
2026	
March 2026	<ul style="list-style-type: none"> High-level review of respondents' feedback
June 2026	<ul style="list-style-type: none"> Full analysis and first read post Exposure Draft
Sept 2026	<ul style="list-style-type: none"> Approval of standard

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APPENDIX TWO

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 ⁹⁹	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.	JFSA	Japan Financial Services Agency	AP
12.	MG	Monitoring Group Chair	GLOBAL
13.	OSC	Ontario Securities Commission	NA
14.	PHSEC	Securities and Exchange Commission (Philippines SEC)	AP
15.	PPPK	Center for Supervision of the Financial Service Profession (Indonesia)	AP
16.	THSEC	Securities and Exchange Commission (Thailand SEC)	AP
17.	UK FRC	United Kingdom Financial Reporting Council	UK
18.	US SEC	US Securities and Exchange Commission	US
Investors and Other Users			
19.	ICGN	International Corporate Governance Network	GLOBAL
Preparers and Those Charged with Governance			
20.	DFCG	Directeur Financier et du Contrôleur de Gestion	EU
21.	ICFOA	International Chief Financial Officers Association	GLOBAL
22.	IoD Kenya	Institute of Directors Kenya	Middle East and Africa (MEA)
23.		M P Vijay Kumar	AP
24.		Mr. Manoj Fadnis	AP

⁹⁹ CEAOB represents auditing oversight bodies in all 27 EU member states.

#	Abbrev.	Stakeholder	Region
Independent¹⁰⁰ National Standard Setters			
25.	AUASB	Australian Auditing and Assurance Standards Board	AP
Professional Accountancy Organizations (PAOs)¹⁰¹			
26.	ACCA	Association of Chartered Certified Accountants	GLOBAL
27.	AE	Accountancy Europe	EU
28.	ICAEW	Institute of Chartered Accountants in England and Wales	EU
29.	ISCA	Institute of Singapore Chartered Accountants	AP
Accounting Firms and Sole Practitioners			
30.	DTTL	Deloitte Touche Tohmatsu Limited	GLOBAL
31.	EY	Ernst & Young Global Limited	GLOBAL
32.	GTIL	Grant Thornton International Limited	GLOBAL
33.	KPMG	KPMG IFRG Limited	GLOBAL
34.	PwC	PricewaterhouseCoopers International Limited	GLOBAL
Academia and Research Institutes			
35.	NUS	National University of Singapore	AP
Others			
36.	FoF	Forum of Firms ¹⁰²	GLOBAL
37.	IFAC CoP	IFAC International Standards Community of Practice	GLOBAL
38.	IFAC SMPAG	IFAC Small and Medium Practices Advisory Group	GLOBAL
39.	INEs	Independent Non-Executives	UK and Global
40.	NSS	National Standard Setters ¹⁰³	GLOBAL
41.	SAC	Stakeholder Advisory Council ¹⁰⁴	GLOBAL

¹⁰⁰ 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.”

¹⁰¹ 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.

¹⁰² 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.

¹⁰³ 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.

¹⁰⁴ 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 THREE

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

- Carillion and KPMG (2018):

The [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 Regeneris plc for the period ended 30 June 2014 ("the Regeneris 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 Regeneris 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 [Securities and Exchange Commission](#) 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 \(PCAOB\)](#) 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 [Public Company Accounting Oversight Board \(PCAOB\)](#) 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 [Public Company Accounting Oversight Board \(PCAOB\)](#) 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)

- [The PwC Australia \(2023\)](#)

The scandal highlighted severe governance and cultural failures within the firm, characterized by breaches of confidentiality and a lack of accountability. ([https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Finance and Public Administration/Consultingservices/Second PwC Report/Chapter 1 - PwC The Cover-up Worsens the Crime#:~:text=The%20committee%20concluded%20that%20PwC.cover%20Dup%20of%20their%20behaviour.&text=1.5This%20report%20also%20sets,the%20matter%20since%20June%202023](https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Finance_and_Public_Administration/Consultingservices/Second_PwC_Report/Chapter_1_-_PwC_The_Cover-up_Worsens_the_Crime#:~:text=The%20committee%20concluded%20that%20PwC.cover%20Dup%20of%20their%20behaviour.&text=1.5This%20report%20also%20sets,the%20matter%20since%20June%202023))

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 Inquiries¹⁰⁵, and ongoing investigations by the Australian Federal Police and the Tax Practitioners Board. (<https://www.afr.com/topic/pwc-tax-scandal-6g22>)

¹⁰⁵ The WG 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 FOUR

Standard-Setting Project – Illustrative Examples

The following are illustrative examples of recommendations and application material in the areas of firm-wide governance framework and independent non-executives 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 establish a governance framework to establish and oversee high standards of professional conduct and ethical behavior to promote the long-term sustainability of the firm.

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 regulation¹⁰⁶).
- 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 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]

Independent Non-Executives (INEs)

A firm that [describe criteria] shall appoint independent individuals to act in a non-executive capacity 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:

¹⁰⁶ See Paragraph 100.7 A1

- Recommend that the responsibilities assigned to such INEs should 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 executive 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]