International Federation of Accountants®

EXPLORING THE IESBA CODE

Installment 3: The Conceptual Framework–Step 2, Evaluating Threats

Professional accountants are guided by fundamental principles that help them uphold their responsibility to act in the public interest. Any threats to compliance with the fundamental principles must be evaluated. In doing so, the accountant is required to use the **reasonable and informed third party** test in determining whether a threat is at an acceptable level.

In Installment 2, we examined how professional accountants should first identify threats—*Self-Interest, Self-Review, Advocacy, Familiarity, Intimidation*—that could impact their ability to comply with the fundamental principles. The next step is to evaluate whether the identified threats are **at an acceptable level**.

The Professional Accountant must use the **reasonable and informed third party test** to evaluate what conclusion a third party would reach with respect to whether, and to what extent, a threat exists.

The reasonable and informed third party is someone who might not be an accountant but has the knowledge and experience to understand the relevant facts and circumstances and impartially evaluate the appropriateness of the professional accountant's decisions and conclusions.

FIVE FUNDAMENTAL PRINCIPLES | **Integrity** | **Objectivity** | **Professional Competence and Due Care** | **Professional Behavior** | **Confidentiality**

Evaluating Threats: Let's use the reasonable and informed third party test to evaluate threats identified by the Director of Accounting Policy, who works for an international manufacturing company.

The CEO has outlined a plan to set up operations in an emerging market. As Director of Accounting Policy, you are not sure the plan complies with bribery and corruption laws.

The company recently lost market share in a strategically important country and the stock has lost 10% of its market value as a result. A credible new plan for entering a high-margin market will satisfy the Board of Directors and shareholders. The CEO has promised sizable bonuses if the team can "get the job done, whatever it takes."

You have reviewed email communications—several of which suggest that money has been transferred to external bank accounts in the target country while the new business plan was being developed.

The Director may be tempted to use the following justification: "Acceptable business practices differ between countries and what might not be allowed in my country might be accepted (or even necessary) in other markets."

The Director's approach differs when considered from the impartial perspective of a reasonable and informed third party. Using this perspective, the Director **would evaluate the types of threats and reach the following conclusions:**

1 **SELF-INTEREST**—Promise of large bonuses could make the Director hesitant to investigate the emails that were uncovered, less objective in evaluating the situation, or less diligent in understanding appropriate anti-bribery laws.

✓ The self-interest threat to integrity, objectivity, professional competence and due care, and professional behavior is **not at an acceptable level**.

2 **SELF-REVIEW**—The Director was not involved in the development of the plan, so there is little threat of him evaluating his own analysis/work.

✓ The self-review threat is **at an acceptable level.**

3 **ADVOCACY**—The Director is not being placed in a position to advocate the company's position. This threat may become more significant if the Director is subsequently asked to "sell" the plan to shareholders or "defend" the plan to tax authorities.

✓ The advocacy threat is **at an acceptable level.**

4 **FAMILIARITY**—The Director may be "too close" to the situation and inclined to agree with the CEO's plan out of implicit trust in the CEO and the company's decision-making processes.

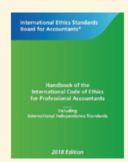
✓ The familiarity threat to integrity, objectivity, professional competence and due care, and professional behavior is **not at an acceptable level.**

5 **INTIMIDATION**—The CEO's "whatever it takes" approach could pressure the Director to just find the "right" answer and approve the plan because jobs and reputations are on the line.

✓ The intimidation threat to integrity, objectivity, professional competence and due care, and professional behavior is **not at an acceptable level.**

Addressing Threats: In the next installment of *Exploring the IESBA Code*, we learn how the Director addresses threats that are not at an acceptable level.

WHERE TO GET ASSISTANCE?



The Reasonable and Informed Third Party Test can be found in paragraph 120.5 A4 of the Code. The conceptual framework is set out in Part 1, Section 120 of the Code. Additional provisions that are relevant to applying this framework are set out in Parts 2, 3, 4A and 4B, Sections 200, 300, 400 and 900 respectively.

IESBA CODE
IESBAeCode.org

The eCode, which is available at www.IESBAeCode.org , is an on-line resource for accountants and other users of the Code. It provides quick and efficient access to the Code, making it easier to use, implement, and enforce.

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