

**Fédération des  
Experts Comptables  
Européens**

Rue de la Loi 83 - 1040 Bruxelles  
Tél 32 (2) 285 40 85 - Fax 32 (2) 231 11 12  
Email: [secretariat@fee.be](mailto:secretariat@fee.be)

**FEE PAPER  
A CONCEPTUAL APPROACH  
TO SAFEGUARDING INTEGRITY,  
OBJECTIVITY AND INDEPENDENCE  
THROUGHOUT THE FINANCIAL  
REPORTING CHAIN**

**November 2003**

---

## CONTENTS

<b>KEY MESSAGES AND CONCLUSION</b>	<b>3</b>
<b>1. INTRODUCTION</b>	<b>5</b>
<b>2. APPLICATION OF CONCEPTUAL APPROACH</b>	<b>7</b>
<b>3. PUBLIC INTEREST PROTECTION SYSTEMS</b>	<b>9</b>
<b>4. ETHICAL REQUIREMENTS</b>	<b>10</b>
<b>5. HOW THE CONCEPTUAL APPROACH WORKS</b>	<b>12</b>
<b>6. THREATS TO OBSERVANCE OF FUNDAMENTAL ETHICAL PRINCIPLES</b>	<b>14</b>
<b>7. THE SAFEGUARDS</b>	<b>16</b>

## KEY MESSAGES AND CONCLUSION

1. The availability of reliable and credible financial information is vital to ensure economic progress and the ability of individuals to make rational business decisions. As a result of the loss of public confidence following corporate scandals in recent years, there is a need for people to act and be seen to act ethically throughout the financial reporting chain, in particular demonstrating integrity, objectivity as well as independence where appropriate.
2. Financial reporting activities other than audit are not exclusively provided by accountants and the accountancy profession cannot rebuild public confidence alone. Relevant bodies, whether individual businesses, regulators or professional associations, need to have in place codes of ethics to ensure this is achieved.
3. This paper outlines a conceptual approach to setting ethical requirements. This approach has gained acceptance from international organisations, initially in relation to auditor independence but also (for example by IFAC) in respect of the wider range of professional work by accountants. FEE believes it is the most appropriate approach to use throughout the financial reporting chain as it offers numerous advantages over a detailed rules based approach. For example, it allows for the almost infinite variations in circumstances that arise in practice and prevents the use of legalistic devices to avoid compliance. The combination of rigour and flexibility of the conceptual approach is the most satisfactory way of ensuring that ethical requirements for auditors, non-executive directors and others in the financial reporting chain are fully observed in the rapidly evolving modern global economy.
4. Ethics codes established in accordance with this approach need not be overly lengthy and detailed. They should:
  - a) Establish fundamental principles which must always be adhered to (we believe the critical principles are integrity and objectivity, which includes independence where appropriate. Others may also be appropriate in different elements of the chain);
  - b) Require analysis (and, where relevant, demonstration) of threats and safeguards;
  - c) Highlight types of threats that might be encountered (self-interest and intimidation are typical categories) and general safeguards that may be applied (typical examples include independent review, disposal of the interest, change of personnel);
  - d) Give examples of typical situations that might be encountered by people working in that part of the financial reporting chain.
5. Oversight is a key element in the process. To support the effectiveness of their ethics codes, bodies need to ensure there is an oversight structure free of the particular threats likely to be encountered by those participating in the financial reporting process.

6. FEE therefore commends the conceptual approach to setting ethical standards to all participants in the financial reporting chain and urges them to take action in this area as an important contribution to restoring confidence in financial reporting. This paper is therefore addressed to:

- Individual companies and business associations
- Company directors
- Business schools, in view of their educational role
- Investment managers and analysts and their professional associations
- Business journalists and their professional organisations
- Regulators
- Those responsible for establishing codes of corporate governance

## 1. INTRODUCTION

This paper outlines the conceptual approach to the setting of ethical requirements with a view to application throughout the financial reporting chain. This paper itself is not meant to be a code, but provides an explanation of how the conceptual framework approach can be used to develop ethical codes and in particular, to assess objectivity in different situations. The conceptual approach was originated by the accountancy profession in Europe<sup>1-2</sup> to produce an ethical code which is of clear intent, workable and which protects the public interest more satisfactorily than a lengthy set of detailed rules, the spirit of which can sometimes too easily be circumvented. In the rapidly evolving modern global economy, it is impractical to list comprehensively all possible threats to ethical behaviour. In fact, such an approach is open to the danger of ignoring threats not specifically mentioned or detailed in the rules. A principles-based approach deals with all situations, including any as yet unforeseen and is therefore all encompassing. A principles-based approach includes guidance, restrictions and prohibitions. By focusing on the underlying aim rather than detailed prohibitions, the principles-based approach combines flexibility with rigour in a way that is unattainable with a rules-based approach. In particular, it:

- Allows for the almost infinite variations in circumstances that arise in practice;
- Can cope with the rapid changes in the modern business environment;
- Prevents the use of legalistic devices to avoid compliance;
- Requires active consideration, and ability to demonstrate the efficacy of, arrangements dealing with, for example, safeguarding objectivity.

The conceptual approach of “allowing unless” can as a result be tougher than a detailed rules based approach, since the principles always need to be obeyed. The events of the last year have, if anything, reinforced this view.

Although applicable to all activities requiring ethical conduct, the conceptual approach has been most visibly applied to auditor independence. Here the key concern is whether the objectivity of the audit is likely to be affected by extraneous factors such as a personal financial interest. It has now been widely accepted internationally as the most robust and appropriate approach to adopt, both within the profession, in particular IFAC<sup>3</sup> and by external regulators, including the European Commission and IOSCO<sup>4</sup>. The Technical Committee of IOSCO recognises the benefits of a threats and safeguards approach on the basis of a framework of principles and refers to the IFAC Code of Ethics.

---

<sup>1</sup> FEE Statutory Audit Independence and Objectivity Common Core of Principles for the Guidance of the European Profession – Initial Recommendations (1998)

<sup>2</sup> Commission Recommendation Statutory Auditors’ Independence in the EU: A Set of Fundamental Principles (2002)

<sup>3</sup> IFAC (International Federation of Accountants) Code of Ethics for Professional Accountants (2001) and Exposure Draft (2003)

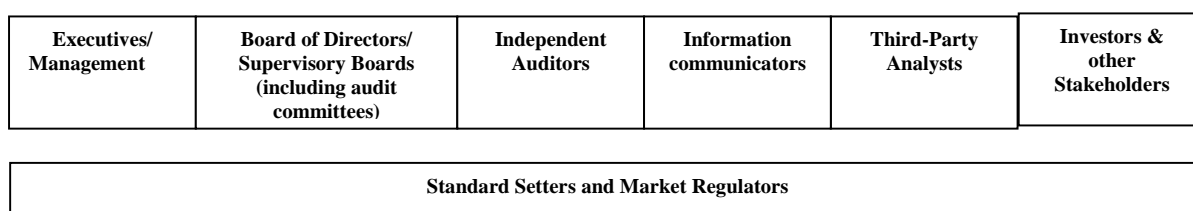
<sup>4</sup> IOSCO (International Organisation of Securities Commissions) Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor’s Independence, paras 9, 11-13 and 15. Para. 13: “Standards of auditor independence should identify appropriate safeguards that the auditor should implement in order to mitigate threats to independence that arise from permissible activities and relationships”. (2002)

The availability of reliable and credible financial information is vital to ensure economic progress and the ability of individuals to make rational business decisions. Governments have long regarded audit quality as a key public interest matter but it is increasingly recognised that the first responsibility of high quality financial reporting in fact lies with management and boards of directors. A recent report by the IFAC Task Force on Rebuilding Public Confidence in Financial Reporting<sup>5</sup> states: “to improve the credibility of financial reporting, action will be necessary at all points along the information supply chain that delivers financial reporting to the market. Corporate managements and boards of directors, who have the prime responsibility for financial reporting, as well as auditors, standard setters, regulators and other participants in the reporting process such as lawyers, investment bankers, analysts, and credit-rating agencies, all have important roles to play and improvements in practices to make to restore the credibility of financial reporting.” The report made a number of recommendations, including proposals that:

- “- Effective corporate ethics codes need to be in place and actively monitored...
- The threats to auditor independence need to receive greater attention in corporate governance processes and by auditors themselves...
- Codes of conduct need to be put in place for other participants in the financial reporting process, and their compliance should be monitored...”

FEE believes that for the improvements to have real effect in substance, such codes should be designed applying a conceptual approach.

The financial reporting chain has several key links<sup>6</sup>:



Codes of ethics for professional accountants, such as that of IFAC, apply to all professional and business dealings of members of accountancy bodies. As such, they encompass audits and other activities typically provided by accountants, such as financial report preparation. However, activities other than audit are not exclusively provided by accountants and the accountancy profession cannot rebuild public confidence alone.

<sup>5</sup> “Rebuilding Public Confidence in Financial Reporting”, issued by the International Federation of Accountants, 6 August 2003

<sup>6</sup> More details can be found in chapter 4 of the 2002 FEE Discussion Paper on Enforcement of IFRS within Europe.

## 2. APPLICATION OF CONCEPTUAL APPROACH

The conceptual approach is not designed exclusively for auditor independence purposes: its structure has application in a wide range of circumstances, where its advantages over a detailed rule-based approach are equally valid. Recent events have highlighted the need for strong ethical behaviour across the financial reporting chain. FEE is of the opinion that the conceptual approach can be used by those responsible for ethical behaviour throughout that chain, particularly at Board (audit committee) and investors, analysts, rating agencies and financial press level. This would be relevant to them both in terms of setting a framework for maintaining, particularly, objectivity in their own link in the chain and in assessing the ethical issues surrounding the auditors' own work. It would also help them to preserve their independence where applicable. Stakeholders need tools to assess the ethical behaviour of all involved in the financial reporting chain. The conceptual approach provides such a tool. Examples of application are shown below.

### *Objectivity and independence of non-executive directors*

It is difficult for anyone receiving direct remuneration from an entity in form of salaries or performance related bonuses to be seen as fully independent without special steps to demonstrate it. However, they can be free of specific influence to the extent that their objectivity is not unacceptably impaired. It is these aspects that an ethic code considers. Independence of non-executive directors and audit committee members is discussed in the Jaap Winter Group Report<sup>7</sup>. "Independent" is considered in the report to mean: "independent of the operational business of the company and of those who take primary responsibility as executive directors, and also not receiving any benefit from the company other than their fully disclosed remuneration as non-executive or supervisory director". The report recommends that there should be effective rules ensuring "that the nomination and remuneration of directors and the audit of the accounting of the company's performance is decided upon by non-executive or supervisory directors who are at least in the majority independent".

The Sarbanes-Oxley Act<sup>8</sup> in the US requires each member of an audit committee to be independent. In the Act, independence broadly means that the individual is not affiliated to the company and that no fee is received other than in his capacity as a director or member of a board committee. The New York Stock Exchange in its revised corporate governance rules (now to be subject to further amendment as a result of proposals issued in October 2003)<sup>9</sup> significantly tightened this definition. NYSE requires that no director can be considered to be "independent" unless the board of directors affirmatively determines that the director has no material relationship with the listed companies (either directly or as a partner, shareholder or officer of an organisation that has a relationship with the company). The NYSE also provides a detailed list of other relationships that would deem a director not to be independent.

---

<sup>7</sup> Report of the High Level Group of Company Law Experts on A Modern Regulatory Framework for Company Law in Europe (November 2002)

<sup>8</sup> Sabanes-Oxley Act of 2002. Act to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.

<sup>9</sup> Amendment Number 2 to the NYSE's Corporate Governance Rule Proposals (October 2003)

The SEC Final Rule on Listed Company Audit Committees<sup>10</sup> requires that each member of the audit committee must be independent. In order to be considered independent, a member of an audit committee may not accept directly or indirectly any consulting, advisory or other compensatory fee from the issuer or any subsidiary thereof.

The European Commission Communication on Company Law and Corporate Governance<sup>11</sup> also states that in key areas where executive directors clearly have conflicts of interests, decisions in listed companies should be made by non-executive or supervisory directors, the majority of whom are independent. It announced that certain minimum standards of what cannot be considered as independent should be established at EU level (short term priority “strengthening the role of independent non-executive and supervisory directors” – recommendation).

The FEE Discussion Paper on Financial Reporting and Auditing Aspects of Corporate Governance<sup>12</sup> states that a key attribute of non-executive directors (NEDs) is their ability to be independent and act independently from management. FEE recommends that:

“Where the national law or codes require certain NEDs to be independent, the (supervisory) board, in its consideration of independence, should use a principles based approach to assess threats and safeguards to independence. Within this approach, fundamental principles, which must always be observed, are defined and any threats which could impede observance of these principles should be identified. Where threats exist, safeguards should be put in place to eliminate or reduce them to an acceptable level. If no appropriate safeguard can eliminate or reduce the risk to an acceptable level, the only safeguard consists in either refraining from participating in the decision making process or resigning. This principles-based approach including guidance and restrictions, combined with prohibitions where appropriate, should give more satisfactory results than a lengthy set of detailed rules, the spirit of which can sometimes be circumvented.

The (supervisory) board should, in addition to identifying the NEDs it determines to be independent with due regard to threats and safeguards, publish its reasons for considering a NED to be independent in the corporate governance statement in its annual report. Such disclosure should include the existence of relationships or circumstances which shareholders (and where relevant, other legitimate stakeholders, such as employees) might reasonably consider relevant to its determination.”

### ***Assessment by governance bodies of auditor independence***

According to the Jaap Winter Group Report, one of the tasks of the audit committee is “to monitor the relationship of the external auditor with the company and its executive management, in particular to safeguard the external auditor’s independence”. FEE is of the opinion that, in particular, the framework approach is the best way for an audit committee to exercise judgement in relation to non-audit services as this approach allows it to consider the relevant threats and safeguards in the particular circumstances under consideration.

---

<sup>10</sup> SEC Final Rule on Standards Relating to Listed Company Audit Committees (April 2003)

<sup>11</sup> Commission Communication of 21 May 2003 “Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward”

<sup>12</sup> FEE Discussion Paper on Financial Reporting and Auditing Aspects of Corporate Governance (September 2003)



### 3. PUBLIC INTEREST PROTECTION SYSTEMS

The regulatory arrangements of professional bodies are part of a wide range of systems designed to protect and promote the public interest against the self-interested actions of individuals. Governments have developed a wide variety of systems to deal with matters as diverse as tax evasion and public health, sometimes implemented by special-purpose statutory bodies such as regulatory or oversight bodies.

In many countries, professions' arrangements are developed on the initiative of the bodies themselves, not in response to external pressures. This is not a purely altruistic initiative. The ability to demonstrate that a profession has rigorous systems for ensuring high standards of conduct is a powerful "marketing tool". It is strongly in the interests of a professional or other representative body, as well as external regulators, to have demonstrably effective arrangements for rooting out behaviour by any of its members which is against the public interest.

Public interest protection systems involve four main elements<sup>13</sup>:

- **The "law"** – a clear statement through legislation or codes of conduct of what is not permissible;
- **Education** – although "ignorance of the law is no excuse", it is incumbent on those imposing complex requirements to ensure that those affected by them are fully aware of their obligations;
- **Detection** – means of ensuring, through receipt of complaints or structured systems of inspection, that infractions come to light;
- **Discipline** – sanctions, proportionate to the offence, which are designed to deter infractions and punish them when they occur.

The remainder of this paper is primarily concerned with the first aspect of this: ethical conduct, in particular objectivity. The other elements are, however, as important as all elements work to reinforce each other.

---

<sup>13</sup> FEE paper The Conceptual Approach to Protecting Auditor Independence (2001)

#### 4. ETHICAL REQUIREMENTS

The “law” can take the form of ethical requirements imposed by professional bodies or by external regulators, or both. They may be more or less conceptual or rule-based in their expression.

To some extent, the distinction between a conceptual and a rule-based approach is a false dichotomy. In a rule-based system the conceptual framework may not be explicitly stated, but if the rules are consistent, they must follow an underlying common principle. The conceptual approach embraces also guidance, restrictions and prohibitions which address commonly encountered situations and which are consistent with the fundamental principles established under the approach.

However the way in which the ethical requirements, including those relating to objectivity, are expressed can have significant consequences for their enforceability. There is usually broad agreement on the underlying objectives of an ethical code. The real issue is whether enforcement will be more effective if the “law” is the conceptual framework itself or is a series of discrete rules derived from the framework.

Proponents of the rule-based approach argue that black and white requirements leave no room for misunderstanding or evasion. However, precisely defined rules can be evaded through arrangements that adhere to the letter but offend against the spirit. An example may help to illustrate the point. A financial institution in a particular country offers a derivative instrument that closely tracks companies’ performance. A literally interpreted rule that, for example, forbade analysts or audit committee members to have an ownership interest in the company concerned would not prevent them from holding such an instrument even though their financial interest would be equivalent to that of a shareholder. Furthermore, in a rule-based system new rules must constantly be developed to meet new circumstances.

Proponents of the “conceptual” approach argue that, by focusing on the underlying aim rather than detailed prohibitions, it combines flexibility with rigour in a way that is unattainable with a rule-based approach. In particular:

1. A set of principles supported by reasoned guidance avoids the argument that any course of conduct that is not specifically prohibited is permissible, encouraging a search for ways around the rules. Ultimately, substance must prevail over form and legalistic devices to avoid compliance will not work.
2. The aim of good guidance should be proactive, i.e. to require the individual concerned – senior management, non-executive directors, audit committee members but also analysts and other players in the financial reporting chain – to identify risks and how they have been addressed, to address and document risks, not just passively to obey the letter of the code. Thus, apart from a number of prohibitions due to an insurmountable threat to objectivity (real or perceived), the judgement is placed in the hands of those who know all the circumstances. They have to be able to demonstrate that they have weighed up the issues and reached a responsible conclusion. This would in particular apply where quality control reviews are undertaken or where perception is a significant issue (such as with auditor independence).
3. It allows for an almost infinite number of circumstances that arise in practice. The framework approach accepts that in some situations there may be appropriate alternative safeguards to those advocated, for they are given only as examples. By comparison, the detailed rules-based approach

---

either has to be almost incomprehensibly complex to cope with all possible circumstances, or is a blunt instrument sometimes imposing inappropriate solutions or completely missing a specific problem.

4. It can cope with continual evolution in the business environment and corporate governance structures, particularly in an international context. A detailed regulatory approach needs to be massively comprehensive and continually updated to deal with this.
5. Principles can be applied to a particular set of circumstances, whereby it is to be recognised that circumstances, the related materiality and subjectivity can vary. There needs to be consideration of the degree and range of threats that may arise and the safeguards that can exist to eliminate or to mitigate threats to objectivity.
6. It is economically disadvantageous to prohibit particular courses of action "just in case" where adequate safeguards can be put in place. Nonetheless, where adequate safeguards cannot be put in place, the approach can include specific prohibitions.

## 5. HOW THE CONCEPTUAL APPROACH WORKS

In broad outline, the conceptual approach works as follows.

- Fundamental principles are set out which must always be observed by the individual<sup>14</sup> concerned. In the case of the accountancy profession, the fundamental principles are integrity, objectivity, professional competence and due care, technical standards, professional confidentiality and professional behaviour. Of these, integrity and objectivity, which requires a state of mind that has regard to all considerations relevant to the task in hand, are particularly relevant to the financial reporting chain given the subjectivity of many financial reporting issues and the consequent need for the exercise of judgement in drawing up financial statements. Indeed, in the IFAC Code of Ethics Exposure Draft, integrity and objectivity underlie the greater part of the ethical code, not just auditor independence requirements.
- The individual must conscientiously consider, before undertaking a responsibility, whether it involves threats which would, or would appear to, impede the observance of the fundamental principles.
- Where such threats exist, safeguards must be put in place that eliminate them or reduce them to clearly insignificant levels. It may be appropriate to declare the existence of the threats to an oversight body (for example an audit committee) for it to determine the need for, and appropriateness of, safeguards
- If fully effective safeguards cannot be implemented, the individual must not carry out the work or participate in a decision. So, effectively a specific prohibition is the ultimate consequence where it is not possible to reduce the threats to an acceptable level or to mitigate the threats.

To take the example of the ethical guidance of the accountancy profession, it uses the conceptual framework approach and includes examples of threats that might arise and appropriate safeguards to deal with them. But these are clearly stated to be illustrative and not comprehensive. In ethical codes using this approach if the individual were charged with a breach of ethical requirements, it would not be a sufficient defence to demonstrate that particular examples of threats and safeguards in the ethical code had been addressed. It would need to be demonstrated that, in the particular circumstances under consideration, the fundamental principles had in fact been observed – a far more rigorous test of compliance.

Where a particular activity or situation would create such a significant threat to observance of the fundamental principles that no adequate safeguard can be envisaged, the code should prohibit the individual or firm from carrying out the activity or participating in a decision. In these particular cases, the conceptual approach can be virtually indistinguishable from rule making.

---

<sup>14</sup> Where this paper refers to an individual in the particular circumstances of an audit, it could also sometimes apply to the audit firm as a whole. In case of other parties of the financial reporting chain, it could, depending on the circumstances, also apply to the organisation.

---

Illustrative is in this respect the Jaap Winter Group Report which introduces the principle: “to qualify as independent the non-executive or supervisory director, apart from his directorship, has no further relationship with the company from which he derives material value”, implicitly in order to avoid a self-interest threat (including financial interests).

## 6. THREATS TO OBSERVANCE OF FUNDAMENTAL ETHICAL PRINCIPLES

Accountants have, and others in a position of trust or special responsibility should have, a professional obligation to comply with fundamental ethical principles. Ordinarily, they should support the legitimate and ethical objectives established by the entity that employs them and the rules and procedures drawn up in support of those objectives. Nevertheless, there may be times when their responsibilities to an employing entity and their professional obligations to comply with the fundamental principles are in conflict. Where compliance with the fundamental principles is threatened, professionals and others in a position of trust must consider their response to the circumstances.

Threats to compliance can take many forms. Many, particularly in respect of objectivity in relation to financial reporting, can be analysed into five different categories:

- A **Self-Interest Threat** occurs when a relevant individual could benefit from a financial or other interest in the entity, as a result of unethical behaviour or independence issues. Examples of circumstances that may create this threat include, but are not limited to:
  - a) Financial interests, loans or guarantees;
  - b) Incentive arrangements;
  - c) Concern over security of employment;
  - d) Interest in transactions with the company;
  - e) Commercial pressure from third parties.
- An **Intimidation Threat** occurs when an individual may be deterred from acting objectively by threats, actual or perceived, from others in an influential position. Examples of circumstances that may create this threat include, but are not limited to:
  - a) Threat of sacking or replacement over a disagreement about the application of an accounting principle or the way in which financial information is to be reported;
  - b) A dominant personality attempting to influence the decision making process by, for example, controlling relations with auditors or other oversight bodies.
- A **Self-Review Threat** occurs when a previous judgement needs to be re-evaluated. Examples of circumstances that may create this threat include, but are not limited to:
  - a) An analyst, or member of a board, audit committee, or audit firm being in a position to exert direct and significant influence over the financial reports;
  - b) Business decisions or data being subject to review and justification by the same person responsible for making those decisions or preparing that data.
- The **Familiarity Threat** occurs when, by virtue of a close relationship an individual becomes too sympathetic to the interests of others. Examples of circumstances that may create this threat include, but are not limited to:
  - a) A person with influence over financial reporting having a close family member who is in a position to benefit from that influence;
  - b) Acceptance of gifts or preferential treatment, unless the value is clearly insignificant;

- c) Getting too familiar with or too close to the management of the organisation.
- An **Advocacy Threat** occurs when a relevant individual promotes, or may be perceived to promote, a position or opinion to the point that subsequent objectivity may be compromised. Examples of circumstances that may create this threat include, but are not limited to:
    - a) Commenting publicly on future events in particular circumstances where outcomes may be doubtful or where information is incomplete;
    - b) Acting publicly as an advocate for a particular position where bias may arise or where the validity of that position may later be called into question.

The Jaap Winter Group Report provides a list of relationships which would cause a non-executive director or member of the audit committee not to be independent:

- “• Those who are employed by the company, or have been employed in a period of five years prior to the appointment as non-executive or supervisory director;
- Those who receive any fee for consulting or advising or otherwise, from the company or its executive managers;
- Those who receive remuneration from the company which is dependent on the performance of the company (e.g. share options or performance related bonuses, etc.);
- Those who, in their capacity as non-executive or supervisory directors of the company, monitor an executive director who is non-executive or supervisory director in another company in which they are an executive director, and other forms of interlocking directorships;
- Those who are controlling shareholders, acting alone or in concert, or their representatives. Controlling shareholder for the purposes of this rule could be defined, as a minimum, as a shareholder who, alone or in concert, holds 30% or more of the share capital of the company.

In defining relations which disqualify a non-executive or supervisory director from being considered to be independent, related parties and family relationships should be taken into account”.

In the context of the conceptual framework approach, this list should not be seen as exhaustive and only as guidance and illustrative examples to identify threats to objectivity. The particular circumstances, materiality and subjectivity should be taken into account in assessing actual threats and safeguards.

## 7. THE SAFEGUARDS

The key to the success of the conceptual approach to safeguarding integrity, objectivity and independence throughout the financial reporting chain is the effectiveness of the safeguards. These apply at high level in the work environment, but specific safeguards are also necessary to deal with particular cases.

### *Safeguards in the work environment*

High level but important safeguards can be put in place by professional bodies, other relevant regulatory bodies, or the entity itself. Such safeguards can include, but are not restricted to:

- a) The entity's systems of corporate or other oversight structures;
- b) The entity's clear commitment to integrity as part of a corporate governance code and related disclosures;
- c) The entity's adoption of its own ethical code (including ethical codes for analysts, investment bankers and press). However, having a code is of no value unless it is respected;
- d) Recruitment procedures emphasizing the importance of employing high calibre competent staff;
- e) Strong internal controls;
- f) Appropriate enforcement processes, both in respect of detection and discipline as well as encouragement of best practice;
- g) Leadership that stresses the importance of ethical behaviour and the expectation that directors and employees will act in an ethical manner, including leading by example (sometimes referred to as "true at the top");
- h) Policies and procedures to implement and monitor the quality of employee performance;
- i) Timely communication of the entity's policies and procedures, and any changes to them, to all employees;
- j) The provision of appropriate training and education to directors and employees;
- k) Policies and procedures to empower employees to communicate to senior levels any ethical issues that concern them. This includes informing employees of the procedures open to them;
- l) Approval by shareholders of transactions of directors with related parties;
- m) Approval by shareholders of share-based payment plans, with appropriate related disclosures in financial statements and corporate governance statement.

For example, boards can show their commitment to the control environment and in particular to ethics, by instigating a programme which could include processes to allow concerns to be voiced by employees, consider the extent to which staff follow both the spirit and the letter of the code and encourage and facilitate continuous improvements in ethical performance. As a means to assessment, companies can use a framework, which might consider issues such as leadership, staff, external interaction with society, internal relations including communication and culture and the company's code of conduct.



### *Specific safeguards*

The FEE Common Core of Principles<sup>1</sup> includes examples of specific safeguards that must always be considered and safeguards that apply to particular cases. Some of these are specific to audit related circumstances, but others are relevant throughout the financial reporting chain.

Examples of safeguards that might apply to particular cases include one or more of the following:

- Immediate notification to the relevant organ or relevant entity of any circumstance resulting in the possibility of a conflict of interest;
- A review of the judgements made by that person, or immediate withdrawal of the individual from the decision-making role or work which is the subject of a conflict. or
- Consideration of the materiality of the amounts and the degree of subjectivity involved (if the amounts are material and the degree of subjectivity is high, the degree of oversight or onus not to be involved is greater;
- Careful demonstration of the safeguards put in place, where appropriate; Additional safeguards which might include the involvement of separate individuals and extra review procedures.

The EC Recommendation<sup>2</sup>, the IFAC Code of Ethics<sup>3</sup> and other ethical codes offer a wide range of examples of safeguards dealing with a variety of circumstances in which threats might arise. But, as mentioned earlier, they are not intended to provide a comprehensive of all the threats and safeguards which might exist. In the modern, rapidly evolving business environment new threats to objectivity are constantly arising and new safeguards must be developed to address them. It is a major strength of the conceptual approach that it allows new circumstances to be dealt with without impossibly long lists of rules and without running the risk that ethical requirements will be evaded (avoiding loopholes) because the new circumstances do not precisely match any previously specified prohibitions.