

## **Draft Consultation Paper: Improving the Clarity of the IESBA Code**

### **I. Introduction**

1. This Consultation Paper has been issued by the International Ethics Standards Board for Accountants (IESBA, the Ethics Board) to seek input on improving the clarity and structure of the IESBA *Code of Ethics for Professional Accountants* (the Code).
2. The purpose of this project is to address ways to improve the usability of the Code, thereby facilitating its adoption or convergence, effective implementation and consistent application. If any changes to the meaning of the Code are identified, they would be subject to the agreement of the Ethics Board and appropriate due process.

### **II. Background**

3. The Ethics Board's objective is to serve the public interest by setting high-quality ethics standards for professional accountants and, by facilitating the convergence of international and national ethics standards, enhancing the quality and consistency of services provided by professional accountants throughout the world and strengthening public confidence in the global accounting profession. It is in the public interest for the Code to be understandable by professional accountants and enforceable by regulators.
4. The Ethics Board has in the past received feedback on the usability of the Code. For example, the Ethics Board has received comments on difficulties in translating some parts of the Code, and understanding complex and long sentences in the Code. An IFAC Small and Medium Practices (SMP) Committee survey stated that the biggest barrier faced by SMPs in fully adhering to the Code is understanding the requirements of the Code and regulators have provided comments on enforceability. These issues affect the usability of the Code and may be impacting adoption and implementation.
5. In order to gain additional insights into the challenges faced by professional accountants, regulators and IFAC member bodies, the Ethics Board researched the views of a broad range of stakeholders from Europe, Australasia, Asia, North and South America, and Africa. Stakeholder groups included regulators, the IFAC SMP Committee, firms, the IESBA-National Standard Setters (NSS) liaison group, IFAC member bodies, some members of the International Forum of Independent Audit Regulators (IFIAR), and the International Organization of Securities Commissions (IOSCO). The Ethics Board also considered a consolidated response in respect of the European profession. The research provides a basis for the proposals in this paper. Any action will be further validated if and when the Ethics Board exposes proposed changes.
6. The research addressed whether there is a case for change and, if so, the nature of any changes that may be necessary. The findings indicated a broad-based appetite for change. There is widespread support from those providing input to raise the visibility of the Code's requirements (Visibility), clarify who is responsible for meeting them (Responsibility), and clarifying the language in the Code on a timely basis.

7. There is also support for, but less urgency associated with, developing a reorganized and electronic Code, and for complementary materials to help users better understand the Code. The Ethics Board is of the view that a reorganized and electronic Code may enhance usability, and should be considered in conjunction with other clarity and structural changes. Complementary materials may best be considered after the Code itself has been clarified and restructured.

### III. Restructuring the Code

8. A number of stakeholders have expressed a strong desire that the Code more clearly distinguish requirements from guidance. They are concerned that the current structure makes it more difficult to identify requirements and may impede compliance and enforcement. Other stakeholders are comfortable working with the Code as currently structured, but the Ethics Board has not identified any reason not to distinguish requirements.

#### *Proposed Approach*

9. The Ethics Board is proposing restructuring each section as follows:

- Purpose;
- Requirements; and
- Application and other explanatory material.

This creates three parts within the sections of the Code, which may need to be made explicit in an introductory section “How to use the Code.” Each of the three parts is presented in separate paragraphs.

#### *Purpose*

10. In the Purpose paragraph, introductory comments describe broadly the context and then briefly what threats may exist, refer users to the fundamental principles and, where relevant, the independence provisions. The Purpose paragraph is intended to explain the purpose of the Section to the professional accountant and to set out the context in which the requirements are to be read. The language is deliberately broad. More specific language is used in the requirements. The Purpose paragraph includes a reminder, at the start of each section, to the professional accountant of the importance of the fundamental principles and the requirement to comply with the principles-based conceptual framework.

#### *Requirements*

11. The Code requires professional accountants to comply with all provisions denoted by the word “shall,” unless compliance is prohibited by law or regulation or an exception is permitted by the Code. The word “should” is not used in the Code as an alternative to “shall.” “Shall” denotes a requirement and is not used in the explanatory sections. Where there is a need to refer in “application and other explanatory material” to a requirement that is already established in the requirements section, wording other than use of the term “shall” is employed.

*Application and Other Explanatory Material*

12. The Ethics Board is mindful of the importance of the conceptual framework approach, which addresses threats to compliance with the fundamental principles rather than simply complying with rules. Any change to the structure of the Code will retain the conceptual framework approach.
13. The “application and other material” paragraphs include:
  - Matters identified as threats but which are not prohibited if sufficient safeguards are available
  - Guidance on what a requirement means or is intended to cover
  - Matters the professional accountant would consider
  - Suggested procedures
  - Examples of procedures that may be appropriate in the context of the engagement or assignment
14. Some regulators have responsibility for auditor independence but not ethics. The Ethics Board is interested in feedback on how separating independence requirements from the application and other explanatory material works with adoption into laws and regulations.
15. Some stakeholders believe that separating requirements from application and other explanatory material may result in the user only reading the requirements and ignoring the explanatory material. The Ethics Board proposes to mitigate this risk by placing the application guidance immediately after the related requirements, rather than placing all requirements in one place and all application guidance in another place. It also proposes including cross referencing between the requirements and the application guidance to link related issues.
16. The Ethics Board proposes to avoid the use of the present tense in application and other explanatory material in relation to actions by the professional accountant where it may be ambiguous whether it imposes an obligation on the professional accountant, or is in fact optional. Such statements would be drafted so as to make it clear that where there is no intention to create a requirement, alternative language is used that appropriately explains the Ethics Board’s intentions. Some “shall” statements in the extant Code that were determined to be interpretations or examples of the application of a requirement are now included as part of “application and other explanatory material.” Those provisions have been redrafted so as not to use “shall” to impose an additional requirement.

**Question**

1. How does the separation of independence requirements from the application guidance work with adoption into laws and regulations?

17. The Ethics Board proposes to add wording to the Code to explain the authority of the three new segments of each Section, for example:

“In addition to purpose and requirements (requirements are expressed in the Code using “shall”), a Section contains related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context relevant to a proper understanding of the

Section. The entire text of a section, therefore, is relevant to an understanding of the purpose stated in a Section and the proper application of the requirements of a Section.”

**Question**

2. Does the separation of requirements from application and other explanatory material make the Code more:
- Understandable?
  - Enforceable?

**IV. Identification of a Firm or Individual Accountant’s Responsibility in Section 290<sup>1</sup>**

18. Various stakeholders have asked that responsibility for compliance with the Code in particular circumstances be clarified. Clarification will facilitate compliance and enforcement.

19. Paragraph 290.12 of the Code states the following:

This section does not, in most cases, prescribe the specific responsibility of individuals within the firm for actions related to independence because responsibility may differ depending on the size, structure and organization of a firm. The firm is required by International Standards on Quality Control (ISQCs) to establish policies and procedures designed to provide it with reasonable assurance that independence is maintained when required by relevant ethical requirements. In addition, International Standards on Auditing (ISAs) require the engagement partner to form a conclusion on compliance with the independence requirements that apply to the engagement.

20. The Ethics Board recognizes that the assignment of responsibility for compliance with the Code will depend on the particular circumstance. The Ethics Board is of the view that clarification of responsibility by reducing the use of the passive voice in Section 290 and developing the guidance currently in paragraph 290.12 may better enable compliance and enforcement. If professional accountants are better able to understand their own responsibility through firms having effective policies and procedures appropriately documented and communicated, to enable individuals to identify who is responsible for compliance with each standard in particular circumstances in regard to independence, compliance with the Code will be enhanced.

21. In March 2014, in response to the IESBA’s consultation on its proposed Strategy and Work Plan 2014-2018, IOSCO stated that an objective of this aspect of the project should be “[t]o clearly identify who specifically within the firm (for example, the firm’s quality control function, firm leadership, the engagement partner or the engagement team) has responsibility for compliance with the Code.” The Ethics Board has considered this input from IOSCO, and input received from other stakeholders, and believes its proposals will facilitate compliance and enforcement. The Ethics Board believes that the optimal way to address this suggestion is to :

- Reduce the number of requirements where the responsibility is unclear because of the use of the passive voice;

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<sup>1</sup> Section 290, *Independence – Audit and Review Engagements*

- Assign responsibility to the “firm” in instances within the independence provisions, except where it is clearly beyond the firm’s control, or assign responsibility to the “professional accountant or the firm” in particular circumstances. Those circumstances are that where a provision applies to a professional accountant, the proposed Code now states “professional accountant,” where it applies to a firm the Code states “firm,” and where it could apply to either, the Code now states both.
  - Currently, the Code relies on a definition of “professional accountant in public practice” that also includes “firm”. This means that the phrase “professional accountant in public practice” has to be used in full each time and also has to be read as and understood to mean “firm in public practice and/or professional accountant in public practice.” In some cases, a requirement can only apply to a person (for example, serving as a member of the audit team), while in many cases, a requirement can apply to both a firm and a professional accountant (for example, providing a valuation service, applying safeguards).
  - Include a requirement in the Code for a firm to establish relevant policies and procedures to assign responsibility rather than relying on a cross reference to International Standard on Quality Control (ISQC) 1.<sup>2</sup>
  - Add guidance to provide examples of who may be a responsible individual within a firm.
22. Many requirements in the extant Code use the passive voice and therefore avoid assignment of responsibility. There are 152 “shall” statements in Section 290. Of these, there are 67 uses of the passive voice where the responsibility is unclear and would require judgment and support of the Ethics Board in assigning responsibility. The Ethics Board proposes reducing the use of the passive voice. For example, 36 instances of the passive voice refer to the application of the conceptual framework, and proposed paragraphs 110.004 and 110.005 assign responsibility for applying the conceptual framework to the professional accountant and firm.
23. The assignment of responsibility to the “firm” as part of independence requirements, except where it is clearly beyond the firm’s control, is more precise than in the extant Code, but it does not allocate individual responsibility, because it is not appropriate in a global Code to prescribe the specific responsibility of individuals within the firm for actions related to independence. Responsibility may differ depending on the size, structure and organization of a firm and the culture in which it operates.
24. The extant Code does not include a requirement that a firm shall have policies and procedures that enable identification of the individual or individuals responsible for maintaining independence in a particular circumstance. The extant Code cross references related requirements in ISQC 1 and the International Standards on Auditing (ISAs). Cross referencing ISQC 1 and the ISAs creates a need to monitor changes to International Auditing and Assurance Standards Board (IAASB) material that may have a knock on effect on the Code. It also assumes that all users of the Code use IAASB material. A new provision is proposed:

*400.006 A firm shall implement, establish and maintain policies and procedures, appropriately documented and communicated, to:*

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<sup>2</sup> ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

- a) *Enable identification of individuals who, in particular circumstances, are responsible for compliance with this section by the firm;*
- b) *Maintain compliance with this section by all individuals within the firm and, as applicable, their immediate and close family; and*
- c) *Require all individuals within the firm to communicate threats to independence to those individuals identified in (a) in order that such individuals may take appropriate action on behalf of the firm to comply with this section. (Ref:400.013, 400.014)*

25. The proposed changes are intended to align the Code with firms' current best practice policies and procedures by introducing a requirement in paragraph 290.12 for the firm to establish policies and procedures that assign responsibility as appropriate to a particular circumstance, and also facilitate identification of a responsible individual.
26. The following text could be added as guidance to provide examples of who may be a responsible individual within a firm:

*Identifying responsibility for firms*

*400.013 Paragraph 400.006 requires the firm to establish and maintain policies and procedures to enable identification of those individuals who are responsible for the firm's compliance with the provisions of this section. Such responsible individuals may include:*

- (a) The engagement partner;*
- (b) Senior individuals responsible for ethics or independence matters for the firm;*
- (c) Any other individual within the firm identified as a responsible individual in relation to a particular matter.*

*400.014 Policies that enable identification of responsible individuals may differ depending on the size, structure and organization of a firm.(Ref:400.006) In addition, International Standards on Auditing (ISAs) require the engagement partner to form a conclusion on compliance with the independence requirements that apply to the engagement.*

27. A list of responsible individuals may be too prescriptive, but in most circumstances it is appropriate for the firm to assign responsibility to an individual with appropriate authority. In addition, it is important to make clear that independence is a matter for individuals, and independence issues are not solely dealt with at firm level.
28. The Ethics Board is of the view that the proposed changes do not change the meaning of the Code. The Ethics Board believes that because it is not appropriate in a global Code to prescribe the specific responsibility of individuals within the firm for actions related to independence because responsibility may differ depending on the size, structure and organization of a firm.

**Question**

3. Do the proposed changes to responsibility provide sufficient clarity to enable professional accountants to understand their own responsibilities and enable the Code to be enforced by regulators?

**V. Clarity of Language**

29. Some users, especially those whose first language is not English, have reported difficulty in understanding the Code, especially the long and complex sentences. For example:
- The Code's definition of certain words to mean something other than their standard definition is confusing and leads to misinterpretation of the Code, e.g., audit means "audit or review."
  - Some terms without common understanding are used in the Code without definition.
  - Some legal and cultural concepts are not understood globally.
  - Readability is not helped by the repeated use of stock phrases such as "the professional accountant in public practice" which is repeated 102 times in the Code, all of which occur in Part B which only applies to professional accountants in public practice. Therefore, "in public practice" is superficially superfluous except for the fact that "professional accountant in public practice" is also defined to include "a firm."
30. Some issues and therefore the related requirements, can be quite complex. However, the Ethics Board does not believe that complex requirements always necessitate long and complex sentences and that there is room for improvement in conveying these issues more clearly.

*Proposed Approach*

31. The Ethics Board has developed drafting conventions in addition to those implemented in 2009. The new drafting conventions aim for improved readability achieved through the following:
- Increased use of the active voice.
  - Simpler and shorter sentences where possible.
  - Avoidance of repetition in the body of the text of terms that are included in the list of defined terms.
  - Avoidance of legalistic and archaic terms, nuances, and superfluous adjectives.
  - Defining repeated phrases used with a particular meaning.
  - Alignment of terminology used in the independence sections with that used by the IAASB.
32. The Ethics Board will consider the translatability of exposure drafts during drafting.
33. *[Insert here Safeguards and Documentation issues if necessary.]*

## Questions

4. Definitions question
5. Safeguards question
6. Documentation question

## VI. Electronic features and reorganization of the Code

34. Some stakeholders find it difficult to navigate around the Code, and there is a risk that a user may not consider all relevant material in the Code. Some of these stakeholders have a particular interest in the independence standards; others, not involved with audits and other assurance engagements, have no interest in the independence standards.
35. Certain stakeholders have expressed interest in raising the profile of the independence section of the Code by splitting independence into individual standards. This may play a part in facilitating navigation. However, care would be needed to avoid losing the linkage between the independence standards and the Code's conceptual framework.

### *Proposed Approach*

36. Taking advantage of the opportunities available with an electronic Code while maintaining a usable printed Code may include:
  - Filtering that enables all, and only those portions of, the Code relevant to the user to be presented.
  - Cross linkages between relevant information. For example, links from the "Purpose" paragraph to the fundamental principles and conceptual framework, and links from requirements to the relevant application and other explanatory material. These are in addition to enhancements to an electronic version of the extant Code which are in progress. These enhancements include an HTML version of the Code, enhanced navigation and links to defined terms.
  - Improved navigability.
37. Either a paper or electronic version of the Code will be the official version. This recognizes that jurisdictions that require laws to be published in the official journal of the relevant Ministry require a paper/pdf version of the Code.
38. Technology will facilitate linking, within the electronic Code, of the detailed requirements and application material in Parts B and C to the overarching considerations in Part A; for example, links to the fundamental principles and to the conceptual framework.
39. Decisions on reorganization should be taken in conjunction with decisions on an electronic Code. An electronic Code may facilitate reorganizing the Code.
40. There will inevitably remain places and occasions where the internet is not easily accessible and users in these areas should have access to a downloaded or paper version of the Code.



41. Relevant factors in the consideration of the merits of re-organization of the Code include:
- Regulators may find it easier to use the Code if Independence is separate from the rest of the Code.
  - Some auditors may limit their actions to examples that are used in Independence to illustrate the conceptual framework. Linking Independence closer to the conceptual framework may encourage a principles-based approach to independence.
  - Whether independence should be separated from the rest of the Code depends on the legal framework of individual jurisdictions.
  - The current link between independence and the conceptual framework is not explicit. Independence is linked to the fundamental principle of objectivity. Section 280<sup>3</sup> expands on the application of the fundamental principle of objectivity and includes a paragraph that states that a professional accountant in public practice shall be independent of an assurance client. However, the link to objectivity is implicit and is not explained. It is important to explain that independence is a means to measure objectivity, but is not an end in itself. The separation of independence from the rest of the Code weakens the connection to the fundamental principle of objectivity. This weakening may encourage users to treat independence as a set of rules that are an end in themselves.
  - The current numbering system of Sections 290 and 291<sup>4</sup> is inconsistent with the methodology used by other standard setters. This makes it difficult to change individual sections without having a knock on effect on other sections. It makes navigation more difficult. It does not differentiate clearly between the main sub-sections within independence.
42. The Ethics Board proposes:
- To cross reference the relevant conceptual framework paragraphs in Part A from Independence.
  - To clarify the linkage between independence and the fundamental principle of objectivity.
  - To maintain Independence as an integral part of the Code, but with a new numbering system for individual sub-sections.

## VII. Issues Related to the Examples

43. *[Further issue, specific to the examples, which are identified by the Ethics Board, will be inserted here for Task Force attention in subsequent meetings. Examples include gaps in requirements or guidance after restructuring.]*
44. T.b.c.]

### Question

7.

<sup>3</sup> Section 280, *Objectivity – All Services*

<sup>4</sup> Section 291, *Independence – Other Assurance Engagements*

## VIII. Impact analysis

45. There was widespread support for the project from stakeholders with an expectation of a positive impact. A part of this consultation is to seek comments from stakeholders on expected impacts.

### Question

8. What impacts, positive and negative, would the proposed changes have on your organization?

## IX. Illustrative Examples (See Agenda Item 5-C)

*Part A – introduction, objectivity*

*Part B – introduction, professional appointment*

*Part B (s.290) – introduction, financial interests, business relationships, valuation services*

*Part B (s.291) – introduction, financial interests, business relationships*

### Question

9. Do you have any comments on the illustrative examples?

### General Questions

10. Would reviewers prefer the exposure draft (ED) that would follow this consultation paper to include the entire Code in a single ED to facilitate an understanding of the linkages between the sections, or a series of EDs for each sub-section of the Code to mitigate the logistical challenges of reviewing an entire Code at one time?
11. Will the proposed changes facilitate compliance with the Code by professional accountants and firms?