

### Structure of the Code—Issues and Task Force Proposals

#### How the Project Serves the Public Interest

Through the development of a restructured Code, the project serves the public interest by:

- Enhancing understandability of the Code, thereby facilitating compliance by professional accountants and enforcement by regulators; and
- Improving the usability of the Code, thereby facilitating adoption, effective implementation and consistent application.

#### How this Paper is Organized

This paper addresses the following topics:

- I. Background
- II. Draft Restructured Code and Preface
  - A. Navigability
  - B. Requirements and Application Material
  - C. Cross-references
  - D. Specific References to Network Firms
  - E. Relocating Certain Material to Subsections
  - F. Labelling and Terminology
- III. Matters For Board Attention
- IV. Other Matters

#### I. Background

1. Stakeholders have provided extensive input throughout this project. The Working Group's initial research involved interviews with a broad cross section of stakeholders, including: the IESBA Consultative Advisory Group (CAG), the International Organization of Securities Commissions (IOSCO), the IESBA-National Standard Setters liaison group, the Forum of Firms, and the IFAC Small and Medium Practices (SMP) Committee. The November 2014 Consultation paper (CP), [\*Improving the Structure of the Code of Ethics for Professional Accountants\*](#), further informed the project.
2. The highlights of the restructuring include:
  - Requirements distinguished – separate paragraphs identified with “R”;
  - Increased prominence of the requirement to apply the conceptual framework and comply with the fundamental principles;
  - Increased clarity of responsibility through reduced use of the passive voice; and

- Increased clarity of language.
3. Additional aspects of the restructuring are as follows:
- New material on how to use the Code;
  - A new title, which remains to be determined;
  - Organization of the material into sections and subsections:
    - Related topics being grouped;
    - Revised numbering to facilitate revisions;
  - Application material positioned next to the relevant requirements – guidance paragraphs identified with “A”;
  - Independence sections moved to the end of the Code and use of more subheadings to facilitate navigation; and
  - Drafting guidelines prepared as a tool for this and other current and future task forces.
4. The Task Force has made significant effort to avoid changes in the meaning of the Code. It has sought to avoid any reduction in requirements or other weakening of the Code. The potential for inadvertent changes in meaning is being closely monitored by using a mapping table to track the disposition of the changes to the Code.

## **II. Draft Restructured Code**

### **A. NAVIGABILITY**

#### *Facilitating Review of the Draft Restructured Code*

5. At the June/July 2015 meeting, IESBA members commented that it would be helpful to be able to more quickly and directly reference the draft restructured Code to the extant Code. In response to these comments, the Task Force has added comments against each paragraph of the draft restructured Code to explain its derivation, i.e., whether it is from a particular paragraph in the extant Code or new material. This has replaced the table of concordance that had previously been provided. The mapping document comparing the draft restructured Code to the extant Code has been retained as a separate document to facilitate review in either direction.

#### *Preface*

6. The draft Preface includes a note to IFAC member bodies and firms, consistent with the extant Preface.

#### *Guide to the Code*

7. The draft Guide to the Code has been prepared to provide users an overview of the Code. It addresses the following topics:
- Interaction with other ethical standards;
  - Purpose of the Code;
  - How the Code is structured;

- How to use the Code; and
- A chart explaining the structure of the Code.

*Positioning the Code for further Enhancements to Navigability*

8. Development of further refinements to electronic features to assist navigability of the Code and preparation of tools to assist the users of the Code will be considered after the Code has been restructured. However, in the course of its current work, the Task Force is giving consideration to positioning the Code for further enhancements to navigability. A matter that has received preliminary consideration is a matrix summarizing the various types of financial relationships for different categories of individual, such as audit team member, immediate family, close family, etc., or entity (firm or network firm) that might hold such an interest. This matrix is being designed to help users identify more easily which paragraphs might apply to their situation.

**Matter for Consideration**

1. Do IESBA members have any suggestions for further improvement to navigability, including improvements to the Preface, the Guide to the Code, and positioning the Code for further enhancements?

**B. REQUIREMENTS AND APPLICATION MATERIAL**

*Reverting to the Term “Application Material”*

9. The sections of the draft restructured Code presented to the Board at its June/July 2015 meeting included “requirements and guidance.” To give due weight to the material accompanying the requirements and as suggested at the June/July Board meeting, the TF proposes changing “guidance” to “application material.”

*Discussion in the Guide to the Code*

10. Paragraph 6 of the draft Guide to the Code explains that the word “shall” denotes a requirement. This explanation was previously included in paragraph 100.4 of the extant Code. It has been relocated to the Guide to the Code as it facilitates an understanding of the requirements in the Code. The word “shall” is used with its normal meaning and requirements are distinguished in the body of the Code.
11. The draft Guide to the Code also includes a discussion of the importance to be assigned to application material:

*In addition to requirements, the Code contains introductory and application material, and a glossary, that provide context relevant to a proper understanding of the Code. In particular this material explains more precisely what a requirement means or is intended to cover and includes examples of relevant facts and circumstances. While such material does not of itself impose a requirement, it is relevant to the proper application of the requirements of the Code. The entire text of the Code, therefore, is relevant to understanding and proper application of the Code’s requirements. Application material is designated with an “A”.*

*Application material that contains the phrases “generally necessary,” “recommended” or “encouraged” indicates that the professional accountant is to use professional judgment in considering when the application material is appropriate for implementation.*

**Matter for Consideration**

2. Do IESBA members have any suggestions for further improvement regarding requirements and application material?

C. CROSS-REFERENCES

*Reduced Cross-references to the Conceptual Framework*

12. The Task Force has utilized subsections to reduce the proposed cross-references to the conceptual framework. Cross-references are included in sections but not in subsections. A header referencing the conceptual framework has been utilized throughout the Code.

*New Reference to Objectivity at the beginning of “Independence for Audit and Review Engagements”*

13. The sections on objectivity<sup>1</sup> mention independence. The Task Force proposes a specific reference to objectivity at the beginning of Parts C1 and C2 which establish standards for independence.

**Matter for Consideration**

3. Do IESBA members have any suggestions for further improvement to cross-referencing within the Code?

D. SPECIFIC REFERENCES TO NETWORK FIRMS

14. The extant Code<sup>2</sup> establishes a general rule for the meaning of “firm” where used in Section 290<sup>3</sup> as follows: “firm includes network firm, except where otherwise stated”. The Task Force believes that there are two problems with this general rule. First, it is capable of being overlooked (as it is only set out at the beginning of Section 290); and second, it could be misinterpreted. The Task Force, therefore, proposes that throughout the restructured independence section for audit clients,<sup>4</sup> the text should refer specifically to firm and network firm (wherever intended) so as to clarify the meaning. The Task Force believes that it is for the most part clear how this general rule is to be applied in specific cases addressed by the Code, such that the term “firm” can simply be replaced with “firm or network firm.”
15. In the process of making this change, however, it has become clear that there is some uncertainty as to the intended meaning of the general rule (“firm includes network firm, except where otherwise stated”) in certain specific paragraphs of the Code. These are those provisions which apply to situations where the “firm” has a particular interest or relationship and the provision requires a determination of whether that interest or relationship is material or significant to the “firm.” The Task

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<sup>1</sup> Section 280 of the extant Code and subsection 112 of the draft restructured Code

<sup>2</sup> Paragraph 290.3.

<sup>3</sup> Extant Section 290, *Independence – Audit and Review Engagements*

<sup>4</sup> Draft restructured Code, Section 500

Force believes that in these particular cases, the original intention of the Code is unclear because the general rule itself was unclear in certain provisions of the Code.<sup>5</sup>

16. In terms of applying the materiality/significance test, the Task Force believes there are three possible interpretations. These are that the test is applied to:
  - (a) The whole of the network in aggregate (i.e., for this purpose “firm includes network firm” means the whole of the network);
  - (b) The firm performing the audit and the relevant network firm that has the interest and relationship combined (i.e., for this purpose “Firm includes network firm” means the relevant network firm taken together with the firm performing the audit); or
  - (c) The relevant network firm only (which, in the case of a situation where the firm performing the audit has the interest or relationship, would mean that the test is applied just to that firm).
17. The Task Force has considered the arguments as to which of these possible interpretations is the most plausible:
  - In the case of (a), the Task Force believes that if materiality/significance were to be assessed with respect to the whole network, the Code would have stated this clearly (i.e., essentially that the “Firm” means the “network”). The Task Force also noted that, for the larger networks, it would be very rare indeed that an interest or relationship with an individual entity would be material to the whole network. This clearly does not seem reasonable and would not meet the independence standard.
  - Interpretation (b) would not be an unreasonable position, in that it is the independence of the firm performing the audit that is of paramount importance. So, it might seem anomalous not to involve that firm in the determination of materiality/significance where another network firm has the interest or relationship. However, it is less clear that the general rule “Firm includes network firm” could be interpreted as “network firm includes the firm” when assessing the materiality/significance of an interest or relationship of the network firm.
  - Interpretation (c) would be consistent with the general understanding that every network firm should be independent of the audit client. For example, it does not seem to be disputed that paragraph 290.104 of the Code requires that no network firm shall have a financial interest in the audit client and this is regardless of the size of the firm, materiality of the interest etc. However, in the case of the types of interests and relationships covered by the particular provisions which do require an evaluation of materiality/significance (as listed above), it is arguable whether it was intended that independence would be breached even if a very small network firm had a relevant interest or relationship that is material/significant to that firm regardless of the particular circumstances.
18. The Task Force is proposing that the relevant paragraphs should be redrafted to apply interpretation (c). In so doing, the Task Force has had preliminary discussions with representatives of the largest networks, but this has not provided a consensus as to which interpretation was intended in the extant drafting of the Code. Although it is likely that the networks would consider materiality to the particular network firm having the interest or relationship, it is also possible that the extant wording would

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<sup>5</sup> Extant Code paragraphs 290.112, 290.120, 290.121, 290.123, 290.124; and the corresponding references in the draft restructured Code are: 511.8, 512.4, 512.5, 521.3, and 521.5

provide sufficient flexibility to enable facts and circumstances to be taken into account, such as the materiality of the network firm to the network, the size of the network firm compared to the firm performing the audit, whether the network firm has any involvement with the audit etc. Any such flexibility would be removed by the wording being proposed by the Task Force. Arguably, therefore, this would be a change in the meaning of the Code.

19. The Task Force wishes to continue to consult on this point, but would welcome views from Board members as to how this issue should be addressed.

**Matter for Consideration**

4. Do IESBA members have any suggestions for further improvement to references to network firms?

**E. RELOCATING CERTAIN MATERIAL TO SUBSECTIONS**

*Second Opinions*

20. Second opinions are addressed in Section 300 paragraphs.<sup>6</sup> The Task Force is currently considering relocation of second opinions to its own subsection.

*Documentation<sup>7</sup>*

21. The Task Force proposes a subsection dealing with documentation, including material of general application and cross references to discussion of documentation for particular matters. The current draft includes material of general application but does not yet include cross references.

**Matter for Consideration**

5. Do IESBA members have any suggestions for relocation of certain material to subsections as discussed above?

**F. LABELLING AND TERMINOLOGY**

*Labelling Parts*

22. At the June/July 2015 Board meeting, an IESBA member questioned whether parts should be labelled A, B, C as in the extant Code or given numeric references. The Task Force had considered this issue previously and reflected on the issue again. It has retained the alpha references to avoid confusion with Parts that contain section numbers that would begin with a number different from a numbered Part.

*Professional Accountants Encompassed by the Term Professional Accountant in Business (PAIB)*

23. The Task Force has clarified the scope of the term PAIB by including particulars in the Guide to the Code.

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<sup>6</sup> Draft restructured Code, R320.7 to R320.7A2

<sup>7</sup> Draft restructured Code, Subsection 402

#### *Use of the Terms “May” and “Might”*

24. While reviewing the draft restructured Code, the Task Force noted that use of the word “might” could be clearer than “may” in certain circumstances. In describing situations that could occur, the Task Force agreed the word “might” would be appropriate. In describing situations where someone is permitted to take action, the word “may” would be more appropriate. For example, see the following sentence:<sup>8</sup>

*The firm **might** ~~may~~ have completed a significant amount of work on the audit prior to the effective date of the merger or acquisition and **might** ~~may~~ be able to complete the remaining audit procedures within a short period of time.*

25. An example of when “may” would be appropriate can be seen in this excerpt:<sup>9</sup>

*When the conditions contained in paragraphs 499.1 to R499.4 are met, specific references to interests and relationships of network firms contained in C1 **may** be disregarded.*

#### *Glossary*

26. The Task Force has located most definitions and descriptions in the Glossary, including words previously included in “Terms Used.” Certain important concepts have been left in the body of the materials, including the fundamental principles, the conceptual framework and network firms. Also, the terms set out in the Glossary that were formerly included in the body of the text as “terms used” will be marked the first time that they occur in a Section, with a footnote referring to the Glossary. An example of a term used that has been moved to the glossary is the term “audit” where it is defined to include “review” for the purposes of Independence – Other Assurance Engagements.<sup>10</sup>

#### **Matter for Consideration**

6. Do IESBA members have any suggestions for further improvement of labelling and terminology?

### **III. Matters for Board Attention**

27. The Task Force has committed to identify in the course of its work matters that the Board might wish to consider for the purposes of considering whether more guidance should be developed by the Board. The Task Force does not believe that developing this guidance is within the scope of the Structure project.

#### *Conceptual Framework – Disclosure Considerations*

28. The Code requires certain disclosure when beaches occur and the professional accountant is unable to end a service. This disclosure is not specifically addressed in the conceptual framework.

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<sup>8</sup> Extract from paragraph R499.9 of the draft restructured Code

<sup>9</sup> From draft restructured Code paragraph R530.6

<sup>10</sup> Draft restructured Code, C1

*Requirements in the Code with Little or no Application Material*

29. Distinguishing requirements from application material has highlighted certain requirements in the Code with little or no application material. This is most apparent in Part A's application material related to the fundamental principles. For example:
- “Integrity also implies fair dealing and truthfulness.”<sup>11</sup> However, there is no explanatory material for these terms and truthfulness is not contrasted to honesty, which is a requirement.
  - A former auditor may not perform certain duties for an audit client unless the individual is not entitled to any benefits or payments from the firm unless made in accordance with fixed, predetermined arrangements.<sup>12</sup> There is no explanatory language to assist in understanding the term “fixed, predetermined arrangements.”
  - Certain application material contains the phrase “generally necessary,” “recommended” or “encouraged” and requires professional judgment.

*Audits of Line Items*

30. The Code has sections dealing with independence requirements for the audit of financial statements, as well as for review engagements and other assurance engagements. The International Standards on Auditing (ISAs) establish standards for the audit of line items in financial statements. The audit of line items in financial statements is not within the scope of independence standards for the audit of financial statements as line items are not covered by the definition of “financial statements” for the purposes of *Independence – Audit and Review Engagements*;<sup>13</sup> nor is the audit of line items within the scope of *Independence – Other Assurance Engagements*<sup>14</sup> as the ISAs stipulate that the work is an audit and not an assurance engagement.

*Documentation Requirements*

31. The Code's documentation requirements have been established over time as various projects have been completed. The subsection collecting documentation relevant to professional accountants in public practice facilitates review of documentation requirements.

*Definitions and Descriptions*

*Alignment with ISAs*

32. There are certain differences between the definitions in the Code and the definitions of the same terms in the ISAs. A list of these definitions was brought to the attention of the Board in October 2014. Subsequent to that discussion, certain stakeholders have suggested that the Code find an alternative to the word “audit client.” This is a matter being addressed by the IAASB and conversations with the IAASB are continuing.

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<sup>11</sup> From extant Code paragraph 110.1

<sup>12</sup> Wording based on extant Code paragraph 290.133

<sup>13</sup> Extant Code, Section 290; draft restructured Code, C1

<sup>14</sup> Extant Code, Section 291 ; draft Restructured Code, C2



“Employee”

33. The term “employee”<sup>15</sup> only covers employees of an audit client and does not clearly include others that may act in the capacity of an employee (i.e., a contractor).

“Materiality” and “Significance”

34. The terms “materiality” and “significance” are not defined.

**Matter for Consideration**

7. Do IESBA members have any suggestions regarding the matters listed for Board attention?

**IV. Other Matters**

*Forward Planning*

Structure of the Code Phase I

35. To meet stakeholder expectations, the Task Force is working towards a target of December 2015 for the approval of an ED of the majority of the parts of the restructured Code. The Task Force Chairs and staff for the Structure and Safeguards projects are liaising closely with each other relative to the aim of seeking Board approval of the Structure and Safeguards EDs by the end of 2015. The dates are tentative, subject to feedback on the proposals and the continued availability of sufficient resources.
36. The Structure Task Force Chair and staff are continuing to liaise with the International Auditing and Assurance Standards Board’s (IAASB’s) ISQC 1<sup>16</sup> Working Group Chair and staff concerning the review and clarification of the matter of responsibility for compliance with the Code in particular circumstances.

Structure of the Code Phase II

37. The Task Force and the Planning Committee are mindful of the need for appropriate alignment of the timing of issuance of the proposed two Structure EDs in relation to the timing of other projects currently in progress. The proposed timing of the sections to be exposed has been slightly adjusted to take account of the expected approval dates for various sections of the Code which are currently under revision or development: NOCLAR; Long Association; extant Part C Phase I, and aspects of safeguards not addressed in the current Safeguards project. Subject to how much progress may be achieved in the available time this year, the Task Force may suggest that the release of the restructured *Independence – Other Assurance Engagements*<sup>17</sup> be deferred until Q2 2016. The Task Force would then seek to have all these sections approved by the Board as a second ED in Q2 2016.<sup>18</sup> The packaging of the EDs is illustrated in the Appendix.

<sup>15</sup> Examples of this can be seen in paragraphs 290.127 and 290.130

<sup>16</sup> International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

<sup>17</sup> Extant Code Section 291; draft restructured Code, C1.

<sup>18</sup> Changes arising from Phase II of the Part C project are expected to be drafted under the new structure and drafting conventions, and issued as a separate ED later in 2016.

38. Responsibility for restructuring certain sections may be assigned to the Task Force dealing with that topic, the Structure Task Force having already prepared and circulated drafting guidelines. The Structure Task Force will support and facilitate coordination of restructuring undertaken by other Task Forces.

*Electronic Code*

39. The Task Force is continuing to reflect on the required functionality for phase II of the electronic Code whilst developing the restructured Code. It has been considering possible filtering options and enhancements to the navigability of the current electronic Code. The Task Force anticipates that if the restructured Code is issued by the end of 2017, then phase II of the electronic Code will be launched during 2018. It will be important that responsibilities are clearly understood and timetables coordinated to achieve timely completion of phase II.

*Forward Timeline*

Indicative Timing	Milestone
October 2015	Forum of Firms meeting <ul style="list-style-type: none"><li>Discussion of ED 1 tranches I and II</li></ul>
December 2015	IESBA Meeting <ul style="list-style-type: none"><li>Approve ED 1 tranches I and II</li></ul>
June 2016	IESBA Meeting <ul style="list-style-type: none"><li>Approve ED 2</li></ul>
Early 2017	Finalize and issue a restructured Code, possibly effective January 1, 2018 (seven years after the effective date of the last major revision)
2018	Launch Electronic Code phase II

**Matter for Consideration**

8. Do IESBA members have any comments regarding the other matters set out above?

Appendix

Structure of the Code – Packaging of EDs

ED 1, Tranche I (June/July 2015 IESBA Meeting)	ED 1, Tranche II (September 2015 IESBA Meeting)	ED 2 (Expected Q2 2016)
Preface/Guide to the Code (First draft) Part A Sections 100 – 115 100 Compliance with the Code, Fundamental Principles and Conceptual Framework 110 Fundamental Principles and Conceptual Framework 111 Integrity 112 Objectivity 113 Professional Competence and Due Care 114 Confidentiality 115 Professional Behavior Part C – Sections 300 – 350 300 Application of the Conceptual Framework for Professional Accountants in Public Practice (Excluding Code to be presented by Safeguards Task Force)	ED 1 Tranche I plus: Part A Section 120 120 Conceptual Framework (Presented by Safeguards Task Force) Part C Section 300 300 Application of the Conceptual Framework for Professional Accountants in Public (Some Code presented by Safeguards Task Force) C1 <i>Independence Audit and Review Engagements</i> 410 Fees and Compensation 411 Fees – Relative Size 412 Fees – Overdue 413 Contingent Fees 414 Compensation 420 Gifts and Hospitality 430 Actual or Threatened Litigation	Part B <i>Professional Accountants in Business</i> . (Extant Part C Phase I). <sup>19</sup> <i>NOCLAR</i> Section numbers TBD 530 <i>Long Association of Personnel with an Audit Client</i> C 2 <i>Independence – Other Assurance Engagements</i>

<sup>19</sup> Extant Part C Phase II expected to be drafted under the new structure and drafting conventions

Structure of the Code – Issues and Task Force Proposals  
IESBA Meeting (September 2015)

ED 1, Tranche I (June/July 2015 IESBA Meeting)	ED 1, Tranche II (September 2015 IESBA Meeting)	ED 2 (Expected Q2 2016)
<p>310 Conflicts of interest</p> <p>320 Professional appointment</p> <p>330 Fees and Other Types of Remuneration</p> <p>340 Gifts and hospitality</p> <p>350 Custody of client assets</p> <p>C1 <i>Independence Audit and Review Engagements</i> Sections 400-521</p> <p>400 Independence – Application of Conceptual Framework to Independence for Audits and Reviews</p> <p>401 Network Firms</p> <p>402 General Documentation</p> <p>403 Merger and Acquisitions</p> <p>404 Breaches of an Independence Provision</p> <p>510 Financial Relationships</p> <p>511 Financial Interests</p> <p>512 Loans and Guarantees</p> <p>520 Other Relationships</p> <p>521 Business Relationships</p>	<p>499 Reports that Include a Restriction on Use and Distribution</p> <p>522 Family and Personal Relationships</p> <p>523 Employment with an Audit Client</p> <p>524 Temporary Staff Assignments</p> <p>525 Recent Service with an Audit Client</p> <p>526 Serving as an Officer or Director of an Audit Client</p> <p>600 Independence: Non Assurance Services</p> <p>601 Management Responsibilities</p> <p>602 Administrative Services</p> <p>603 Preparing Accounting Records and Financial Statements</p> <p>604 Valuation Services</p> <p>605 Taxation Services</p> <p>606 Internal Audit Services</p> <p>607 IT Systems Services</p> <p>608 Litigation Support Services</p> <p>609 Legal Services</p>	

Structure of the Code – Issues and Task Force Proposals  
*IESBA Meeting (September 2015)*

ED 1, Tranche I (June/July 2015 IESBA Meeting)	ED 1, Tranche II (September 2015 IESBA Meeting)	ED 2 (Expected Q2 2016)
	<p>610 Recruiting Services</p> <p>611 Corporate Finance Services</p> <p>Glossary</p> <p>Table of Contents:</p> <p>To be produced for December 2015 ED</p>	