

**DRAFT Minutes of the 50<sup>th</sup> Meeting of the  
INTERNATIONAL ETHICS STANDARDS BOARD FOR ACCOUNTANTS  
Held on December 12-15, 2016 in New York, USA**

**Voting Members**

Present: Stavros Thomadakis (Chairman)  
Richard Fleck (Deputy Chair) (Days 1, 3 and 4 only)  
Helene Agélii  
Brian Caswell  
Kim Gibson  
Gary Hannaford  
Liesbet Haustermans  
Claire Ighodaro  
Robert Juenemann  
Chishala Kateka  
Atsushi Kato  
Stefano Marchese (Days 1-3; Day 4 by teleconference)  
Ian McPhee  
Reyaz Mihular (Days 2-4 only)  
Patricia Mulvaney  
Lisa Snyder  
Sylvie Soulier

Apology: Michael Ashley

**Technical Advisors**

Saadiya Adam (Mr. Mihular)  
Tony Bromell (Mr. Ashley)  
Denise Canavan (Ms. Haustermans)  
Elbano De Nuccio (Mr. Marchese) (Days 1-3 only)  
Michael Dorfan (Ms. Kateka)  
Jason Evans (Mr. Caswell and Ms. Snyder) (Days 1, 3 and 4 only)  
Tone Maren Sakshaug (Ms. Agélii)  
Heidi Martinez (Ms. Gibson)  
Andrew Pinkney (Ms. Mulvaney)  
Jens Poll (Mr. Hannaford)  
Eva Tsahuridu (Mr. McPhee)  
Toshihiro Yasada (Mr. Kato)

**Non-Voting Observers**

Present: Kristian Koktvedgaard (IESBA Consultative Advisory Group (CAG) Chair) and Takuya Emoto (Japanese Financial Services Agency (FSA))

Apology: Juan Maria Arteagoitia (European Commission)

**Public Interest Oversight Board (PIOB) Observer**

Present: Jane Diplock

**IESBA Technical Staff**

Present: James Gunn (Managing Director, Professional Standards), Ken Siong (Technical Director), Diane Jules, Kaushal Gandhi and Elizabeth Higgs

## 1. Opening Remarks

### WELCOME AND INTRODUCTIONS

Dr. Thomadakis welcomed all participants and public observers to the meeting. He welcomed, in particular, Ms. Diplock, observing on behalf of the PIOB. He also welcomed Mr. Koktvedgaard, Chair of the IESBA CAG, and Mr. Emoto, the Japanese FSA observer. In addition, Dr. Thomadakis introduced Mr. Clarke as Ms. Soulier's new Technical Advisor, and Ms. Adam as Mr. Mihular's new Technical Advisor. Apologies were received for Mr. Ashley and Dr. Arteagoitia.

### IESBA MEMBER, TECHNICAL ADVISOR AND STAFF CHANGES

Dr. Thomadakis noted that this would be the last Board meeting for Ms. Ighodaro and Mr. Kato who were both retiring from the IESBA after the December 2016 meeting. Mr. Bromell would be attending his last IESBA meeting as Technical Advisor to Mr. Ashley and would be replaced from January 2017 by Mr. James Barbour, ICAS Director of Technical Policy.

Dr. Thomadakis indicated that this Ms. Higgs would be returning to the UK on completion of her contract at the end of February 2017. She has agreed to continue to support the Structure of the Code ("Structure") Task Force as an external contractor until the end of December 2017. Dr. Thomadakis announced that Mr. Geoffrey Kwan, observing the meeting in person, would be joining the IESBA staff in January 2017 as a Manager, Standards Development and Technical Projects.

Dr. Thomadakis thanked all individuals who were leaving for their contributions to the IESBA's work and wished them the best for the future.

### RECENT OUTREACH ACTIVITIES

Dr. Thomadakis provided an update on outreach activities since the September 2016 IESBA meeting. He informed the Board that he and Mr. Siong had been undertaking outreach in South America in November 2016. Among other activities, this outreach included workshops at the IFAC Council meeting in Brazil on the Board's new pronouncement addressing the topic of non-compliance with laws and regulations (NOCLAR), and meetings with various stakeholders in Brazil, Chile and Peru, including regulators, national ethics standard setters, investors, preparers, audit committee members, IFAC member bodies, firms and academics. He felt that it was an enriching experience, with much interest among the stakeholders in NOCLAR. He added that the outreach had helped raise the visibility of the Board and its work in this important region of the world, and he was much encouraged by the positive impression he had taken away. He believed the Board should continue its outreach efforts in the region, and thanked Mr. Juenemann for assisting in organizing some of the meetings in Brazil and for participating in the outreach in Brazil and Chile.

Dr. Thomadakis also thanked all IESBA representatives who had participated or will participate in outreach, and encouraged Board participants to conduct outreach and become ambassadors for the Board within their own jurisdictions.

### PLANNING COMMITTEE (PC) UPDATE

Dr. Thomadakis reported that the PC had met in person in October 2016 and by teleconference in November 2016 to consider, among other matters, the development of the strategy survey; a draft response to the PIOB strategy consultation paper; and preparations for the NOCLAR workshops at the November 2016 IFAC Council meeting.

### *Task Force and Working Group Changes*

Dr. Thomadakis also reported that the PC had discussed Task Force and Working Group compositions for 2017 in light of Board member rotations. With advice from the PC, he had invited the following individuals to join the following Task Forces and Working Groups, and they had accepted:

- Mr. Hannaford will join the PC.
- Mr. Thomson will remain as the Chair of the Structure Task Force until the anticipated completion of the project in December 2017.
- Mr. Hughes will continue as a member of the Structure Task Force until December 2017.
- Mr. Ashley will join the Part C Task Force, replacing Ms. Ighodaro.
- Ms. Gibson will join the NOCLAR Task Force and Implementation Working Group, replacing Mr. Kato.
- Mr. McPhee will join the Fees Working Group.
- Ms. Soulier had agreed to act as the IESBA liaison to the International Auditing and Assurance Standards Board (IAASB).
- Messrs. Bromell and Kwok would be completing their service on the Structure and Safeguards Task Forces, respectively, at the end of this year.

### OTHER MATTERS

Dr. Thomadakis noted the PC's recommendation that the December 2017 IESBA meeting be held in Livingston, Zambia. This would be the IESBA's first meeting in Africa, a region where the IESBA has had limited visibility. He felt that it would also be fitting for the meeting to be held in Ms. Kateka's home country as this would be her last meeting on the Board. Staff will research an appropriate meeting venue and advise the Board in due course.

### MINUTES OF THE PREVIOUS MEETING

The minutes of the September 26-30, 2016 Board meeting were approved as presented.

## **2. Long Association**

Mr. Fleck introduced the topic, outlining the key achievements on the project, including strengthened general provisions addressing long association with respect to all audits, and a more robust cooling-off regime for engagement partners (EPs) and engagement quality control reviewers (EQCRs) on audits of public interest entities (PIEs). He then led the Board through the matters for consideration.

### JURISDICTIONAL PROVISION

Mr. Fleck reminded the Board of the thinking behind the "jurisdictional provision" which the Board had finalized at the September 2016 meeting, i.e., that the cooling-off period of five years for EPs on all PIE audits may be reduced to three years provided that the jurisdiction has (a) established requirements for a time-on period shorter than seven years, or mandatory firm rotation (MFR) or mandatory re-tendering of the audit appointment after a predefined period, or joint audits; and (b) implemented an independent regulatory inspection regime. He reported that the PIOB had subsequently questioned whether the jurisdictional provision was necessary as it added to the overall complexity of the provisions. The PIOB had also expressed the view that by allowing a reduction in the cooling-off period for EPs to three years, the

jurisdictional provision would weaken the overall partner rotation regime in the Code. It had added that stricter rules in national legislation, such as mandatory firm rotation, would prevail and apply.

Mr. Fleck then outlined the Task Force's proposal in response to the PIOB concerns. He noted that while this revised proposal was a simplification, the Task Force believed that it was weaker than the original provision because it no longer contained the various conditions. He explained that the revised proposal contained a "sunset clause" intended to address the PIOB's concerns about the jurisdictional provision amounting an exception that resulted in an overall insufficient improvement in the cooling-off regime in the Code. He added that while the Task Force felt that this sunset clause was necessary, it would be subject to review in accordance with the Board's previous commitment to review the revised long association provisions post-implementation as part of the next strategy and work plan (SWP).

A few IESBA members expressed concern about the revised proposal now no longer containing any conditions and therefore no longer reflecting the rationale behind the original jurisdictional provision, i.e., to recognize that some jurisdictions may have taken alternative approaches to addressing threats created by long association. Other IESBA members were of the view that removing the conditions would not substantively change the intended objective under the original provision. It was in particular noted that while more time would have been welcome to debate the issue, the revised proposal seemed to achieve the main objective. Dr. Thomadakis concurred, noting that the critical issue was whether the revised proposal retained the original desired outcome.

Many IESBA members questioned the appropriateness of the sunset clause. Some noted that the Code has not previously contained such a clause and accordingly this would be setting a precedent that could warrant re-exposure. Others wondered how it was intended to operate. A few suggested that it would be better to move it to the Effective Date part of the section. It was also observed that other standard setters generally address the concept of a "sunset" as part of their post-implementation review of the effectiveness of their standards.

Some IESBA members wondered how the post-implementation review of the sunset clause would be performed, including the basis for the review and the documentation that would be needed. A few IESBA members were skeptical that there would be sufficient data for the post-implementation monitoring given that many jurisdictions take a long time to adopt changes to the Code. It was also felt that a sunset clause would create a fluid environment as it implied that the jurisdictional provision would be re-opened for review two to three years after it becomes effective. Mr. Fleck noted that long association is an area that remains in flux given external legislative and regulatory developments, and accordingly a post-implementation review of the section would be needed. He added that there would be opportunity to take into account the experiences of jurisdictions that implement the changes, such as Australia as it moves from a 7/2 regime to a 7/3 regime, as well as jurisdictions such as the EU that are already implementing MFR. Dr. Thomadakis indicated that the sunset clause was addressing PIOB concerns that the jurisdictional provision was offering a permanent exception to some jurisdictions. He added that there had also been prior reservations of some members of the Board about granting a permanent exception to the EU in particular. The revised formulation was now much less specific to the EU.

Some IESBA members were of the view that providing a transitional period as part of the effective date would be a better approach compared with the proposed sunset clause. It was felt that such a transitional approach would be simpler. It was also suggested that it should be made available to all jurisdictions, effectively allowing them during a period of five years from the effective date to apply the higher of (a) a cooling-off period of less than five years specified by a legislative body or regulator (or organization

authorized or recognized by such a legislative body or regulator), and (b) three years, before an eventual changeover to the five years.

After further deliberation, the Board broadly supported:

- With some minor refinements, the Task Force's proposal for the revised jurisdictional provision, recognizing that there was a greater public interest in bringing the overall improvements to the long association provisions to market as soon as possible; and
- The transitional approach to the revised jurisdictional provision, provided that a post-implementation review of the section take place during the transitional period. The Board generally agreed that this approach would not require further consultation with stakeholders. The Board also agreed that the transitional provision should articulate the rationale for this approach, i.e., that it is intended to facilitate the transition to the cooling-off period of five years in those jurisdictions where the legislative body or regulator (or organization authorized or recognized by such legislative body or regulator) has specified a cooling-off period of less than five years.

In addition to the post-implementation review, the Board also committed to:

- Brief the CAG at the earliest opportunity on the changes to the text agreed at the September 2016 IESBA meeting;
- Explain the developments leading to, and the reasons for, those changes in the Basis for Conclusions; and
- Commission staff to develop appropriate FAQs to further explain the application of the transitional provision with respect to jurisdictional provision.

#### ALLOWANCE FOR LIMITED CONSULTATION DURING THE COOLING-OFF PERIOD

Mr. Fleck briefed the Board on the PIOB's concerns regarding the provision granting an exception for an EP or EQCR who has rotated off a PIE audit engagement to provide consultation to the engagement team on a technical or industry-specific issue after two years have elapsed during the cooling-off period if that individual is also, or becomes, a technical specialist within his or her firm. Specifically, the PIOB had questioned the appropriateness of this exception to the general principle that consultation with an EP or EQCR is prohibited during his or her cooling-off period. In this regard, the PIOB had wondered whether the general provision addressing restrictions on activities during the cooling-off period could be simplified by eliminating the exception. Mr. Fleck explained that in the light of the PIOB comments, the Task Force proposed that the exception be withdrawn.

A few IESBA members noted that the withdrawal of this exception would likely increase the challenges for SMPs in auditing PIEs. A broader concern was also expressed that with all the changes in response to the PIOB comments, stakeholders might perceive that the revised provisions are more supportive of the larger firms than the smaller firms. Mr. Caswell, Board liaison to the IFAC SMP Committee, briefed the Board on the concerns from the Committee on the proposed changes.

After further deliberation, the Board supported the Task Force's proposal to withdraw the exception.

#### EFFECTIVE DATE AND TRANSITIONAL PROVISIONS

Mr. Fleck outlined the rationale for the Task Force's proposal for the effective date of the revised long association provisions in extant Sections 290 and 291,<sup>1</sup> i.e., audits of financial statements for periods beginning on or after December 15, 2018 for the former, and December 15, 2018 for the latter. In both cases, early adoption would be permitted.

Mr. Fleck noted that while the Board had debated at length in September the merit of providing transitional provisions before the revised Section 290 provisions become effective, the PIOB had expressed concern about the need for such transitional provisions. The PIOB had in particular noted that the revised provisions would not become effective until two years after their finalization. The Task Force therefore proposed that no transitional provisions be provided in relation to the overall revised provisions.

The Board supported the Task Force's proposal.

#### APPROVAL

After considering all the necessary changes to the document, the Board approved it as a final close-off document under the extant structure and drafting conventions with the affirmative votes of 15 out of the 17 IESBA members present. Ms. Agélli abstained and Mr. Kato voted against the revised document for the reasons outlined below.

#### CONSIDERATION OF RE-EXPOSURE

Mr. Siong outlined the grounds for re-exposing an approved document under the Board's stated due process and working procedures. Mr. Fleck summarized the rationale for the Task Force's conclusion that re-exposure would not be warranted. In particular, respondents have already had an opportunity to comment on the need for a jurisdictional provision. While the formulation of this provision has been changed in response to the PIOB comments, it still retained the original objective of permitting jurisdictions to apply a cooling-off period lesser than five years for EPs as long as this has been established by an appropriate body in the jurisdiction, subject to a floor of three years. Also, the Board would review the revised provision during the transitional period. With respect to the exception regarding limited consultation during the cooling-off period, Mr. Fleck noted that this issue had also been previously exposed.

Mr. Koktvedgaard noted that the CAG had already debated both issues at length. He did not believe that there was a need for re-exposure. While there was not a unanimous view at the CAG on each of these issues, the CAG was overall supportive of the revised long association package as a whole. He added that the CAG appreciates the need for the Board to balance stakeholders' views and take into account the PIOB's views. He indicated that he had informed the CAG the previous week that a teleconference would be arranged after the Board to brief them on the outcome of the Board discussion.

Having assessed the nature of the changes, the Board voted on whether to re-expose the agreed document. Of the 17 IESBA members present, except for one member, there were no affirmative votes in favor of re-exposure.

Mr. Kato voted for re-exposure as he was of the view that the criteria for re-exposure had been fully met given that the text agreed at the September 2016 meeting had been substantially changed. He noted that the Board had already discussed extensively the feedback from respondents to the two EDs and the related revisions to the provisions at the previous Board meetings. Accordingly, he was of the view that it was

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<sup>1</sup> Section 290, *Independence – Audit and Review Engagements*; and Section 291, *Independence – Other Assurance Engagements*

unclear why further changes would be needed at this late stage. Also, he noted that these further changes would be included in the ED of the restructured provisions and he was concerned that stakeholders would not understand the differences between the final substantive changes and the restructuring changes which are not intended to change substance. He was also of the view that the Board discussion on the jurisdictional provision illustrated a lack of clarity regarding the objectives of the changes, which he felt had the potential for unintended consequences. In addition, he felt that transitional provision attached to the jurisdictional provision was unusual and that many stakeholders would have difficulty understanding the monitoring process for the provision post-implementation.

Mr. Kato also believed that eliminating the exception regarding limited consultation during the cooling-off period would adversely affect SMPs and, accordingly, it would be important to seek their views on re-exposure. He was also of the view that a substantially revised standard should normally be accompanied by a transitional provision to smooth the change from the extant standard to the new standard. Accordingly, he felt that the Board should seek stakeholders' views regarding not providing for a transition period. Finally, he expressed concern about the confusion caused by the late PIOB comments. He felt it important that the Board has a clear and transparent due process, and he did not believe that this would be achieved without re-exposure.

#### PIOB OBSERVER'S REMARKS

Ms. Diplock noted that she had listened to the Board debate carefully. She concurred with views that had been expressed in the Board discussion that it is important to focus on the outcome and desired effect of the revised provisions. She added that it is in the public interest to be clear upfront that the objective in the long association section is a five-year cooling-off period with relief for a transitional period. She felt that separating the two would water down the section.

#### PROPOSED RESTRUCTURED TEXT

Mr. Fleck led the Board through the Task Force's proposed restructuring changes to the final close-off document. Mr. Hannaford highlighted the proposed conforming changes arising from the Safeguards project.

The Board supported the proposed restructured text with some editorial refinements and approved it for exposure with the affirmative votes of 16 out of the 17 IESBA members present. Mr. Kato voted against issuing the restructured text for exposure for the reasons noted above.

#### WAY FORWARD

Ms. Diplock congratulated the Task Force and staff, adding that the outcome of the Board deliberation is appropriate and in the public interest. Dr. Thomadakis also conveyed his congratulations to the Task Force and staff and, in particular, the Chair of the Task Force for successfully leading this project to this stage.

The Board asked staff to circulate a draft Basis for Conclusions for the final close-off document for its consideration at the earliest opportunity after the Board meeting. Subject to PIOB approval of the close-off document, the Board asked staff to finalize the ED of the restructured text for issuance with the ED of Phase 2 of the Structure project in January 2017.

### 3. Professional Skepticism

Mr. Fleck introduced the topic, outlining the objectives of the session and summarizing the activities on the initiative since the September 2016 Board meeting. He noted that the IESBA PS Working Group's (WG's) proposals were in response to the concerns raised by stakeholders regarding professional skepticism (PS) in the context of the Code. The project proposal and related two-part short-term (ST) proposal were intended to introduce:

- New application material to explain the linkage between PS as defined in the IAASB standards and required for audit, review and other assurance engagements, and the fundamental principles/independence; and
- A new requirement for all professional accountants (PAs) to apply a critical mindset when applying the conceptual framework to assist in complying with the fundamental principles. This was intended to add a degree of rigor to the PA's exercise of professional judgment and therefore enhance that judgment.

Mr. Fleck then briefed the Board on advance feedback received on the proposals, including from the IAASB-IESBA-International Accounting Education Standards Board (IAESB) PS Working Group (PSWG), the IAESB, IESBA CAG, the IAASB, and the IFAC SMP Committee. With respect to the IAASB, he noted that some concern had been expressed regarding the "critical mindset" proposal and a question as to the difference between the concepts of PS and critical mindset. With respect to the IFAC SMP Committee, he noted a question as to whether the proposed requirement to apply a critical mindset would increase PAs' work effort on their engagements. He explained that this was not the intent as the provision was aimed at emphasizing that they should carefully think about the facts and circumstances of each situation.

He then briefed the Board on the main comments from the CAG teleconference the previous week, including:

- Clear support from some CAG Representatives for the WG's proposals.
- Suggestions that the project proposal more clearly define the problem that the proposed requirement to apply a critical mindset was intended to address and better explain how the ST project fits with the longer-term initiative of the PSWG.
- The need to better explain the anticipated effects of the proposed changes from a cost-benefit perspective.

In this regard, Mr. Koltvedgaard noted that some CAG Representatives had wondered about the value of the proposals, given that the WG did not expect that they would significantly increase the cost of performing professional activities, including audit engagements.

Mr. Fleck explained that the proposals also incorporated input from the Safeguards and Structure Task Forces. He noted that the Planning Committee had also considered the proposals and was of the view that, if approved by the Board, they should be released in a stand-alone exposure draft (ED) rather than being subsumed with the EDs relating to those two other projects.

Mr. Fleck then sought views about each component of the WG's two-part proposal and the project proposal.

Some IESBA members wondered about the need to prioritize an ED at this time, especially given that the topic of PS is not an item in the current Strategy and Work Plan. It was noted that there are major disruptions in the marketplace such as technological developments that would better deserve the Board's strategic attention. It was also questioned whether it would not be more advisable to bypass ST efforts and focus

more holistically on a longer term project, especially given the commitment for a joint effort among the IAASB, IESBA and IAESB. In addition, there was a concern as to whether the Board would have sufficient time and resources to undertake such a project in the ST given its already full agenda, as well as a concern about overwhelming stakeholders with EDs given the planned January 2017 releases of the EDs relating to the Structure, Safeguards and Part C projects.

Some IESBA members also wondered what the concept of a critical mindset would add to the Code. There was a view that the application of a critical mindset is already embedded in professional judgment and the fundamental principles more broadly. Accordingly, there was a question as to whether the concept of a critical mindset could be addressed via professional judgment, i.e., applying a critical mindset when exercising professional judgment. There was also a view that there is some overlap between critical mindset and PS, and that proposing a requirement for PAs to apply a critical mindset might create confusion among stakeholders. In this regard, there was a suggestion that if the concept of a critical mindset is not the same as PS, it would fit better as part of the Safeguards project.

Other IESBA members expressed support for the WG's proposal regarding critical mindset, with some seeing value in recognizing it for all PAs in the Code. It was noted that the extant Code currently is silent on it although stakeholders would accept that all PAs should apply it. There was also a view that there is a gap in the extant Code and that the public interest would be better served when PAs other than auditors (e.g., PAs in business (PAIBs)) apply a critical mindset in undertaking their professional duties. Accordingly, it was suggested that there would be value in the Code being explicit about it. Nevertheless, there were some views that the concept of PS in the Code should be consistent with how it is defined in the IAASB's standards.

Acknowledging the concerns raised about timing and resources, Dr. Thomadakis nonetheless felt that there is value to the Code being explicit about the concept of a critical mindset and that there is validity to extending it to all PAs.

#### WAY FORWARD

Mr. Fleck thanked IESBA members for their feedback. He acknowledged the concerns about Board resource constraints and the burden of EDs on stakeholders. He concluded that the WG would reflect on the feedback and aim to come back to the March 2017 Board meeting with a simpler and clearer set of proposals.

#### 4. **Structure of the Code**

Mr. Thomson introduced the topic, recapping the aims and status of the project and the key features of the restructuring. He summarized the nature of the main changes from ED-1, including addressing unintended changes of meaning; separating the Guide to the Code (the Guide) from the Code; giving greater prominence to the requirements to comply with the fundamental principles and, where relevant, be independent; and clarifying the link between provisions addressing independence and objectivity. He then outlined recent Task Force activities and the session's objectives, thanking IESBA participants who had provided advance comments on the Structure agenda material for this Board meeting.

#### PROPOSED RESTRUCTURED TEXT PHASES 1 AND 2

Mr. Thomson explained that after the September 2016 Board meeting, the Task Force had refined the wording of Phases 1 and 2 of the proposed restructured Code. He noted that this included updates for NOCLAR conforming amendments and editorial changes following a review to ensure compliance with the

drafting guidelines, including consistency of drafting by other Task Forces involved in the restructuring effort.

#### PREFACE, GUIDE, PARTS 1 AND 3 (SECTIONS 100 TO 120 AND 300 TO 350)

Mr. Thomson summarized the editorial changes made in response to comments at and following the September 2016 IESBA meeting. These changes included clarifications to paragraphs 100.3 A2 and 112.2 A1, conforming amendments from the NOCLAR and Safeguards projects and consistency changes.

Among other matters, the following were raised:

- Whether paragraph 100.3 A1 should be expressed as a requirement, given that it is an exemption to the requirement to comply with the Code as it states that if there are more stringent provisions within a particular jurisdiction, those provisions apply. Mr. Thomson explained that paragraph R100.3 requires that a PA comply with the Code unless laws and regulations required a different action, in which case laws and regulations prevailed. Accordingly, it was appropriate that paragraph 100.3 A1 explained the need to comply with laws and regulations.
- Whether the sentence added to Paragraph 114.2 A1 should explain that confidentiality has a broader purpose as the sentence seemed to convey the impression that confidentiality only serves the narrow purpose of the public interest. Mr. Thomson explained that this paragraph was a conforming amendment introduced by NOCLAR, and as such it was not within the Task Force's mandate to change its meaning.

#### PART 4-A – SECTIONS 400 TO 525

Mr. Thomson summarized the editorial and other changes made in response to comments at and following the September 2016 IESBA meeting. These changes included removing the reference to an “audit of specific elements, accounts or items of a financial statement” in paragraph 400.10; refining the changes to paragraph R400.52 regarding network firms; and in paragraphs 520.4 A1 and 520.6(c)(ii) further clarifying the application of the materiality or significance test to network firms.

Among other matters, the following were raised:

- Whether the beginning of paragraph 400.52 A1 would be better placed as context for paragraph R400.51 because it introduces the concept of larger structures.
- The reason for the deleted sentence in paragraph 400.70 A1. Mr. Thomson explained that advance feedback from Board members indicated that the sentence was covered in R400.75 and that it was duplicative to include it in both places.
- Regarding the application of the materiality or significance test to network firms, the extant Code being more concerned with the business relationship being immaterial or insignificant from the firm's perspective and not necessarily the network firm's perspective. Mr. Thomson explained that in the extant Code, the term “firm” is defined to include “network firm.” This therefore led to the possibility that the provisions regarding network firms could be construed in different ways. The proposed restructured Code distinguished the provisions which related to firms and network firms. To address this issue, the Task Force proposed that the wording revert to the text used in Structure ED-1.

## THE GLOSSARY

Mr. Thomson summarized the editorial and other changes in response to comments at and following the September 2016 IESBA meeting. These changes included adding new explanations regarding usage of the terms “may” and “might;” “predecessor accountant” and “proposed accountant;” and adjustments to the definitions of “professional accountant in business” and “reasonable and informed third party.” In addition, the terms “cooling-off period” and “eligible audit engagement” had been added as described terms, and “materiality” had been deleted as a described term.

Among other matters, the following were raised:

- A suggestion to simplify the description of the material contained in the second paragraph of the Glossary explaining the differences between defined and described terms. This could be achieved by explaining that the “Definitions” section of the extant Code has been enhanced and presented as a Glossary, which also includes described terms.
- The possibility of losing the distinction between the terms “may” and “might” upon translation in languages such as Swedish, which, for example, uses the same word for “may,” “might,” and “can.” Mr. Thomson explained that the Structure Task Force believed that the use of “may” and “might” as described better conveyed the intended meaning of the Code and the descriptions would assist translators in choosing the right words. In this regard, Mr. Siong emphasized the need for translations to reflect the intent of the Code and he recommended that the Board retain the descriptions in the Glossary.
- Whether the cross-references to the term “threats” in paragraphs 120.5<sup>2</sup> and 300.5<sup>3</sup> in the Glossary could be restricted to paragraph 120.5 for the sake of brevity.

## EFFECTIVE DATE FOR RESTRUCTURED CODE

Mr. Thomson outlined the Task Force’s rationale for its proposal of June 15, 2019 for the effective date, including the need for adequate time to be provided to stakeholders for adoption and implementation activities, including translation, assuming that the restructured Code is issued by the end of Q1 2018.

Among other matters, the following were raised:

- Whether there would be two different effective dates for different sections of the Code as the agenda material indicated an effective date for audits of financial statements for periods beginning on or after June 15, 2019. Mr. Thomson indicated that it was not intended for there to be two different implementation dates. For auditors, the effective date would need to be by reference to a financial statement period as they are required to be independent during the period covered by the financial statements as well as throughout the performance of the audit engagement. He noted that the effective dates for the NOCLAR and revised Long Association provisions were determined separately from the Structure project.
- Why the effective date was not until 2019 when the changes were only restructuring in nature. Mr. Thomson explained that the challenge was not only with the volume of the restructured text, but also with the nature of the changes. For example, the changes to the references to “firms” and network forms” might necessitate a firm paying particular attention to the restructuring changes in that regard.

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<sup>2</sup> Proposed Section 120, *The Conceptual Framework*

<sup>3</sup> Proposed Section 300, *Applying the Conceptual Framework - Professional Accountants in Public Practice*

In addition, the changes arising out of the Safeguards project might require firms to take additional actions that would necessitate an adequate implementation period. Mr. Hannaford concurred with Mr. Thomson, noting that stakeholders would need time to address Safeguards-related implementation issues.

#### THE ELECTRONIC CODE

Mr. Thomson explained that work on the electronic Code was a separate initiative to which consideration would be given once Structure ED-2 had been published.

#### PHASE 1 – AGREED-IN-PRINCIPLE TEXT

After due consideration of all the necessary changes to the Phase 1 text, the Board agreed it in principle, subject to any general matters of consistency that might arise as a result of Structure ED-2.

#### PHASE 2 – STRUCTURE ED-2

Mr. Thomson explained that the Task Force had refined the wording of Sections 800 and 900 to reflect conforming amendments from the Safeguards project and for consistency with Phase 1 in accordance with the drafting guidelines. He noted that the Structure Task Force had overseen the consistency of the restructuring work by the Long Association, NOCLAR, Part C and Safeguards Task Forces. He explained the arrangement of Structure ED-2 and the placement of the texts from the Part C, NOCLAR and Long Association projects alongside the text for which the Structure Task Force was responsible.

#### PARTS 4-A AND 4-B (SECTIONS 800 AND 900)

Mr. Thomson summarized the editorial changes made in response to comments at and following the September 2016 IESBA meeting. These included reordering the text to conform to the Phase 1 drafting conventions. IESBA members had no comments on those changes.

#### APPROVAL OF STRUCTURE ED-2

After duly considering all the necessary changes to the document, the Board approved it for exposure with 16 affirmative votes out of the 16 IESBA members present. The comment period will be for a minimum of 120 days from the date of issuance of the ED.

Mr. Thomson thanked all Task Force members and staff for their hard work in achieving the outcomes on Phases 1 and 2. He noted that the development of the restructured Code had progressed well, with extensive outreach to many stakeholders, who viewed the project as important.

Dr. Thomadakis concurred, noting that the conclusion of the project would have far reaching implications for stakeholders and the profession. He joined Mr. Thomson in thanking the Task Force and staff for their contributions. He thanked especially Mr. Thomson for leading the project and for his excellent coordination efforts.

#### WAY FORWARD

The Board asked that staff circulate the draft explanatory memorandum for ED-2, the draft Basis for Agreement in Principle for Phase 1, and the draft IESBA Update communication for comment in early January 2017.

## 5. Safeguards

### PHASE 1 – AGREEMENT IN PRINCIPLE ENHANCEMENTS TO THE CONCEPTUAL FRAMEWORK

Mr. Hannaford introduced the topic, providing a recap of the conclusions the Board had reached regarding the revisions to the text of the December 2015 Exposure Draft, [\*Proposed Revisions Pertaining to Safeguards in the Code – Phase 1\*](#) (Safeguards ED-1) in response to the feedback from respondents and the CAG. He noted that the Task Force had continued to work very closely with the Structure Task Force, and that certain parts of the proposals were developed in conjunction with the Structure Task Force. Mr. Hannaford explained that the changes to the previous draft were limited in nature, including:

- Proposed Section 120:
  - Clarifications to distinguish safeguards as actions that might reduce the level of threats to an acceptable level in comparison to factors relevant to evaluating the level of threats; and actions that might eliminate threats.
  - Refinements to the description of reasonable and informed third party (RITP) to take into account drafting suggestions from some IESBA members and CAG representatives.
- Proposed Section 300
  - Refinements to the examples of facts and circumstances that might create threats when PAs in public practice (PAPPs) undertake professional services.
  - Refinements to the application material for evaluating threats to better align it to paragraph 120.6 A1 which describes the role of conditions, policies and procedures established by the profession, legislation, regulation, the firm or the employing organization.
  - Refinements to the examples of actions that in certain circumstances might be safeguards to address threats.

Among other matters, IESBA members raised the following:

#### *Proposed Section 120*

- Some IESBA members believed that the provisions in the conceptual framework should be explicit so as to avoid confusion among PAs. It was in particular suggested that the proposed text clarify that when new information results in the identification of a new threat, PAs should be required to evaluate and, as appropriate, address those threats.
- With respect to the description of the RIPT, the appropriateness of the word “impartiality” in paragraph 120.5 A1. Mr. Hannaford explained that the September 2016 draft included the words “in an objective manner” and that the change was in response to a suggestion to better convey an important characteristic of a RITP. Upon further reflection in light of the discussion, the Task Force proposed using the words “in an impartial manner.”

#### *Proposed Section 300*

- Whether an additional example was needed under the category of advocacy threats in paragraph 300.6 A1. Upon further reflection in light of the discussion, Mr. Hannaford explained that the Task Force agreed to include “...lobbying in favor of legislation on behalf of a client” as an example of a fact or circumstance that might create such a threat. He explained that the Task Force did not intend

for the list of examples to be comprehensive, but that the Task Force believed that it was helpful for the Code to include an example based on issues PAs currently deal with.

### *Agreement in Principle*

After considering all the necessary changes to the document, the Board agreed in principle the text of Phase 1, subject to any matters of general consistency that might arise from Phase 2.

### PHASE 2 – PROPOSED SECTIONS 600<sup>4</sup> AND 950,<sup>5</sup> PROVISION OF NON-ASSURANCE SERVICES (NAS)

Mr. Hannaford introduced the topic, recapping the main proposals in Phase 2, i.e.:

- When providing NAS to audit clients, firms are required to comply with the fundamental principles, be independent, and apply the conceptual framework to identify, evaluate and address threats to independence.
- In addition to enhanced general requirements and application material to identify, evaluate and address threats created by providing NAS more broadly, firms and network firms are required to apply specific requirements relevant to providing certain NAS to audit clients.
- For those subsections that include prohibitions of certain NAS (i.e., Sections 601, 603, 604, 605, 606, 608, 609 and 610), flagging in the introductory part of the section that in some circumstances the specific NAS is expressly prohibited because the threats cannot be eliminated, or because there can be no safeguards to reduce the threat to an acceptable level.

Mr. Hannaford then summarized the revisions made to the general provisions and each of the subsections. Among other matters, the following comments or suggestions were raised:

### *Proposed Section 600*

#### General Provisions

- In relation to the third bullet in paragraph 600.4 A4 pertaining to an example of a factor that might be relevant to evaluating the level of threats created by providing NAS to an audit client, whether it would be clearer to revise it to state that "...the level of expertise of the client's employees with respect to the type of service provided."
- In relation to the exception to the requirement to avoid assuming management responsibilities when providing certain NAS to related entities of the audit client,<sup>6</sup> why the phrase "otherwise be prohibited" was used instead of "otherwise restricted" in the extant Code. Upon review of the history of the provision, the Board agreed that the change was not intended to change the meaning of the extant provisions, but rather to align to the new structure and drafting conventions.

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<sup>4</sup> Proposed restructured Code, Part 4A, Independence – Audits and Reviews, Section 600, *Provision of Non-assurance Services to an Audit Client*

<sup>5</sup> Proposed restructured Code, Part 4B, Independence – Other Assurance Engagements, Section 950, *Provision of Non-assurance Services to an Assurance Client*

<sup>6</sup> Extant paragraph 290.157 states that "A firm may provide non-assurance services that would *otherwise be restricted* under this section to the following related entities of the audit client ..." Paragraph R600.10 states that "Section 600 prohibits assuming management responsibilities...As an exception to those requirements, a firm or network firm may assume management responsibilities or provide non-assurance services that would *otherwise be prohibited* to the following related entities of the client..."

#### Subsection 601 – Accounting and Bookkeeping Services

The IESBA reaffirmed its position regarding the permissibility of providing accounting and bookkeeping services to audit clients that are PIEs and those that are not PIEs. The IESBA also agreed to retain the extant prohibitions on firms and network firms from providing accounting and bookkeeping services to:

- Audit clients that are not PIEs when the NAS is related to financial information which forms the basis of the financial statements on which the firm will express an opinion unless:
  - (a) The services are of a routine or mechanical nature; and
  - (b) The firm addresses any threats created by providing such services.
- Audit clients that are PIEs, including preparing financial statements on which the firm will express an opinion, or financial information which forms the basis of the financial statements. The exception with respect to accounting and bookkeeping services that are of a routine or mechanical nature for divisions or related entities is retained.

Ms. Diplock noted that the Board's deliberations on the topic was helpful in clarifying the provisions in the Code, in particular as relates to the prohibitions on providing accounting and bookkeeping services to audit clients that are PIEs.

#### Subsection 604 – Taxation Services

- The appropriateness of having "...seeking advice..." as an example of an action that might be a safeguard. Upon further reflection, the Task Force revised its proposals to clarify that consultations and advice might help in evaluating the level of threats, but are not examples of actions that might be safeguards to address threats.

#### Subsection 605 – Internal Audit Services

- The addition of the word "audit" in the first sentence of paragraph 605.6 A1 which read "When a firm uses the work of an internal audit function in an audit engagement, International Standards on Auditing require the performance of procedures to evaluate the adequacy of that *audit* work..." seemed to narrow the provisions in the extant Code.

#### *Proposed Section 950*

Mr. Hannaford explained the nature of the revisions to Section 950, noting that the changes were intended to conform to proposed Section 600.

A suggestion was made to reconsider the use of the word "ensure" in the second sentence to paragraph R950.5 which read "... the firm shall ensure that the responsibility is not related to the subject matter or subject matter information of the assurance engagement provided by the firm." It was noted that it would be unreasonable to place the burden directly on the entire firm to ensure that a breach of such provision never occurs, including with respect to any future assurance engagements the firm might undertake. Upon reflection, the Task Force revised the sentence to "... the firm shall establish appropriate policies and procedures to ensure that the responsibility ...."

#### *Phase 2 – Proposed Conforming Amendments*

Mr. Hannaford explained the nature of the proposed conforming amendments arising from the Safeguards project to other areas in the Code, including to the proposed restructured texts developed by the Structure,

Long Association and Part C Task Forces. He explained that some of those conforming amendments are also necessary to be consistent with the new structure and drafting conventions.

*Conforming Amendments Relating to Part 2 of the Restructured Code<sup>7</sup>*

Mr. Hannaford explained that the Task Force had liaised with the Part C and Structure Task Forces in developing conforming amendments to the PAIB section of the Code. He added that the three Task Forces were in agreement that the conceptual framework applies to PAIBs. On that basis, they agreed to conforming amendments to align the material in Part 2 of the Code to the conceptual framework set out in Section 120.

Mr. Hannaford highlighted the significant conforming amendments in Part 2, including those relating to:

- Re-characterizing the “factors for determining whether the pressure could result in a breach of the fundamental principles” in the [Part C Phase 1 close-off document](#) (e.g., discussions and consultations with others) to “considerations to assist PAIBs determine whether there are conditions, policies and procedures established by legislation, regulation or the employing organization that might help them understand the level of threats.”
- Aligning the requirement for addressing threats in proposed Section 270 to the requirement in paragraph R120.10.
- Using the word “breaches” to refer only to circumstances when the PA has not complied with the fundamental principles versus as a short-hand to refer to threats to compliance with the fundamental principles (i.e., the potential for a breach of a fundamental principle).

Some IESBA members questioned the appropriateness of some of the Task Force’s revisions to replace the word “breaches” with “threats to ...” in Part 2. Others questioned whether similar changes needed to be made elsewhere in the Code, e.g., in Parts 4A and 4B in relation to breaches to independence. In conjunction with the Structure Task Force, the Task Force reviewed the proposed restructured Code to ensure that a consistent approach to the drafting was used.

*Approval of Safeguards ED-2 for Exposure*

After duly considering all the necessary changes to the document, the Board approved it for exposure with 17 affirmative votes out of the 17 IESBA members present. The comment period will be for a minimum of 90 days from the date of issuance of the ED.

WAY FORWARD

The Board asked the Task Force to present a summary of the significant matters raised on the ED at its June 2017 meeting.

**6. Review of Part C of the Code**

RESTRUCTURING

Ms. Agélii introduced the topic by recapping the history of Phase 1 of the Part C project. She then summarized the key restructuring changes to the Phase 1 text along with the main changes to the glossary description of a PAIB.

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<sup>7</sup> Part 2, *Professional Accountants in Business*

In addition to drafting and editorial suggestions, the following matters were raised:

*Example of Advocacy Threat*

- The current proposed example of an advocacy threat is more an example of unethical behavior and should be reconsidered. Ms. Agélii noted that the Task Force had considered alternatives and did not identify a more suitable example. IESBA members agreed that the proposed example should be retained and provided editorial suggestions to better phrase it as an advocacy threat.

*Glossary Description of PAIB*

- Some of the sectors in which a PAIB might work are not business sectors, if the phrase “in business” is interpreted as a commercial activity. There was therefore a question as to whether the term “professional accountant in business” might need to be amended to take into account non-commercial sectors. On the other hand, the International Accounting Standards Board (IASB) has defined the phrase “in business” as a process that results in an output. The output does not necessarily have to be financial. Thus, the current description is appropriate. Ms. Agélii noted that changing the term PAIB was beyond the scope of the Part C project.

*Approval for Exposure*

Suggested drafting and editorial changes to the proposed restructured text were processed and a revised restructured Part 2<sup>8</sup> presented at a later session of the meeting with Ms. Agélii summarizing the key changes. After duly considering all the necessary changes to the document, the Board approved it for exposure with 17 affirmative votes out of the 17 IESBA members present. The comment period will be for a minimum of 90 days from the date of issuance of the ED. The ED will be packaged as part of Structure ED-2.

APPLICABILITY PARAGRAPHS

*Final Wording of “Applicability Paragraphs”*

Ms. Agélii recapped the Board’s previous deliberation over the applicability of Part C to PAPPs and the proposed “applicability paragraphs.”

A few IESBA members were of the view that the directions in the “applicability paragraphs,” notably the paragraph containing the example, were not aligned with directions in Section 120 of the restructured Code, where the “applicability paragraphs” will be placed. In particular, it was noted that while Section 120 considers matters pertaining to the conceptual framework, the proposed example relates to requirements and application material on pressure, a topic that is not addressed until proposed Section 270.<sup>9</sup> A Task Force member explained that the aim of maintaining the example in Part 1 was to emphasize that the Code needed to be considered holistically and ensure that a PAPP would not consult only the sections aimed specifically at PAPPs and ignore Part 2. An IESBA member agreed that it was imperative to include the example in Section 120 to provide clarity as to why a PAPP might find themselves having to consider provisions in Part 2.

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<sup>8</sup> Proposed Part 2, *Professional Accountants in Business*

<sup>9</sup> Proposed Section 270, *Pressure to Breach the Fundamental Principles*

IESBA members generally agreed that it would be preferable for the example to outline an intra-firm scenario rather than consider situations involving a client that would suggest a willful violation of auditing standards. Consideration was then given to alternative options, with the Board agreeing to revise the example to one relating to a partner pressurizing junior staff to undercharge time served on an engagement in order to improve the perceived profitability of the engagement.

#### *Approval for Exposure*

After duly considering all necessary changes to the “applicability paragraphs,” the Board approved them for exposure with 17 affirmative votes out of the 17 IESBA members present.

Ms. Agélii recounted that while the “applicability paragraphs” were originally planned to be packaged as part of Structure ED-2, further discussion between the Structure and Part C Task Forces had led to the conclusion that this would not be appropriate as the paragraphs constituted a substantive change which conflicted with the remit of the Structure project. Ms. Agélii then outlined the following options for exposing the paragraphs:

- Within the Part C Phase 2 ED, due to be approved in March 2017; or
- In a standalone ED to be released in December 2016, alongside Structure ED-2.

Mr. Siong noted that the Task Force had expressed a preference to expose the paragraphs with the Part C Phase 2 ED. This would allow stakeholders, especially those who had previously not been required to consider the provisions within Part 2, to review all sections within Part 2 including the proposed revised Section 250.<sup>10</sup> He advised the Board to expose the paragraphs with Structure ED-2 as implementation of the paragraphs was not conditional on proposed Section 250. Should the paragraphs be incorporated into the Code, all current and future provisions within Part 2 would need to be considered by a PAPP facing ethical issues not involving clients.

The Chair of the Structure Task Force expressed a view that given the possible ramifications that introduction of the paragraphs would have for PAPPs, stakeholders might find it useful to have the “applicability paragraphs” ED available alongside Structure ED-2. He added that since the Part C Phase 2 ED was primarily aimed at PAIBs, PAPPs might not fully consider the consequences should the paragraphs be exposed with this ED in March 2017. Dr. Thomadakis and a few other IESBA members concurred. A few other IESBA members expressed a preference for the paragraphs to be exposed within the Part C Phase 2 ED to avoid overloading stakeholders and allow them additional time to adequately consider issues raised within all the EDs.

After further deliberation, the Board supported exposing the paragraphs in a standalone ED with Structure ED-2.

#### *Title of Part 2*

Ms. Agélii explained how the proposed introduction of the “applicability paragraphs” would render the extant title “Professional Accountants in Business” inconsistent with the broadened scope of the provisions in Part 2 which would now apply to PAPPs in their activities outside of client relationships. Changing the title to reflect this change in scope might result in an overlap with the extant title of Part 3,<sup>11</sup> which might then also

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<sup>10</sup> Proposed Section 250, *Gifts, Hospitality and Other Inducements*

<sup>11</sup> Extant Part B, *Professional Accountants in Public Practice*

need to be changed. An alternative solution could be to introduce sub-headings under the titles of both sections to clarify the scope of the provisions that the sections contain.

Several IESBA members believed that the title should not be changed. Among other matters, it was noted that:

- While the title could be adjusted, it would be preferable to maintain the term PAIB as it is a known and defined term.
- Maintaining PAIB in the title would emphasize that PAIBs are obliged to apply the provisions within this part of the Code. Otherwise, PAIBs might inadvertently overlook the guidance believing it to be not applicable to them.

The Chair of the Structure Task Force acknowledged that while the titles of Parts 2 and 3 should be consistent with the scope of the provisions within them, if the Board's preference was to maintain the current titles, alternative methods of ensuring that the scope of the Parts is clear could be considered.

After due consideration, the Board determined not to propose any change to the extant title for Part 2.

#### REVISED SECTION 250

Ms. Agélii recounted that the Board had considered a strawman at its September 2016 meeting, with IESBA members generally agreeing with the suggested structure. She summarized the key changes made to the strawman based on feedback received at the September 2016 meeting and presented the revised text as a first read. In addition to editorial and drafting suggestions, the following matters were raised.

#### *Guidance on Bribery and Corruption*

The Task Force had repositioned guidance on bribery and corruption to clarify that the provisions in Section 250 are aimed at inducements that might breach the fundamental principles, with a reminder for the PA to understand all applicable laws and regulations concerning inducements.

A participant noted that applicable laws and regulations can include jurisdictional as well as extraterritorial legislation. Ms. Agélii acknowledged the point, adding that as per the NOCLAR provisions, reference has not been made to specific legislation as it would be impossible to write a standard that encompasses all specific laws and regulations.

#### *Definitions of the Terms "Bribery" and "Corruption"*

After significant deliberation, the Task Force had decided against including definitions for bribery and corruption in the proposed text. Definitions used by other organizations were considered, notably the Transparency International (TI) definitions that were included in the TI presentation at the January 2015 IESBA meeting. However, the Task Force had not incorporated such definitions within the revised Section 250 as they might conflict with definitions at the jurisdictional level.

The Task Force also believed that definitions of these terms were not essential. If an inducement is illegal, it would be covered by laws and regulations. If it is not illegal, the proposed principles-based provisions would assist the PA in addressing possible ethical conflicts. Several IESBA members agreed that defining these terms was not imperative, with a few IESBA members adding that greater clarification of the nature of inducements falling within the scope of the section was needed within the application material.

Participants offered the following additional views and information:

- Mr. Siong noted that while IFAC has been working with the OECD in promoting the role of PAs in the fight against bribery and corruption, it had not itself defined the terms.
- If a definition were to be included in Section 250, it should be from an authoritative organization.

*Proposed Title of Section 250*

The Task Force had not amended the proposed title of Section 250, “Gifts, Hospitality and other Inducements,” but had clarified (a) what constitutes an inducement, and (b) that the term “inducement” is neutral.

A few IESBA members were of the view that the term “inducement” is not neutral and that gifts and hospitality should not be considered inducements. It was suggested that the word “other” could be removed from the title to indicate that gifts and hospitality are not inducements. A Task Force member noted that the Board had previously agreed that the term inducement is neutral and, accordingly, additional application material had been added to clarify this.

*Intent Test*

The Task Force proposed to maintain the intent test in the revised section on the grounds that the intent behind an inducement is key to determining a possible threat to compliance with the fundamental principles. It would also assist in taking into account cultural differences, as a PA could still apply the proposed provisions on evaluating possible threats and implementing safeguards when an inducement is made without any adverse intent, regardless of the cultural circumstances.

The Task Force had also added factors to consider to assist the PA in addressing the intent, as well as a requirement not to offer or accept an inducement if it could be perceived that the inducement is being made with an adverse intent. The Task Force was of the view that the reasonable and informed third party (RITP) test was not sufficient to evaluate the perception of intent regarding an inducement as it might also be possible for an individual other than a RITP to form an adverse perception.

IESBA members agreed that the intent test was necessary. However, several IESBA members were of the view that it would be appropriate to utilize the RITP test in assessing the intent. It was noted that while there might be room for a more discerning test to evaluate intent, no such test currently exists. The Chair of the Safeguards Task Force noted that specific reference to the RITP test could be made within the proposed section if it is felt necessary to highlight its importance, as has been done in the NOCLAR provisions.

In contrast, a participant supported the Task Force’s view that an adverse perception of an inducement could be made by an individual other than a RITP, especially for accountants where details of the inducement might be reported in the media. Such an individual could perceive an inducement as creating a threat to compliance with the fundamental principles. A Task Force member added that incorporating an expectation higher than the RITP test provided an opportunity to raise the standard of ethical conduct and hence should not be discounted.

An IESBA member noted that the proposed factors to assess the intent behind an inducement were the same as the factors to evaluate possible threats associated with an inducement, and that this repetition could be confusing. Ms. Agélii explained that the factors would be applied in different circumstances, but that the Task Force would further consider the matter.

IESBA members did not comment on the Task Force's proposals that any inducement made with an actual or perceived adverse intent must be declined, but a "trivial and inconsequential" inducement with no adverse intent can be accepted.

#### *PIOB Observer's Comments*

Ms. Diplock expressed a view that the Board should consider the public interest when deciding on the type of test that is needed to evaluate the perceived intent behind an inducement, adding that a layered approach could be considered that accommodated individuals other than a RITP.

#### *Conforming Changes to Section 340<sup>12</sup>*

Ms. Agélli explained that conforming changes will be made to Section 340 to align it to the proposed Section 250. Conforming changes will result in a revised Section 340 addressing acceptance of inducements, a matter that the extant section did not address. The proposed Section 340 will be tailored to suit PAPPs, notably as relates to the examples of threats and different types of inducements. An IESBA member expressed a view that when tailoring guidance for Section 340, consideration should be given to clarifying that the counterparty offering or receiving the inducement will be a client.

#### WAY FORWARD

Dr. Thomadakis thanked the Task Force and staff for their efforts, especially in restructuring the Part 2 text and developing the ED of the "applicability paragraphs."

The Board then asked the Task Force to present a revised draft of the proposed Section 350 with a view to approval for exposure at its March 2017 meeting.

#### **7. Fees**

Ms. Kateka introduced the session, noting that the Fees Working Groups' (WG's) fact finding initiative is aimed at understanding whether there is a relationship between fees and threats to compliance with the fundamental principles and to independence. She noted that the session would be a briefing on the first two stages of the WG's fact finding work, which comprises:

- A review of relevant academic research;
- An overview of the relevant fee provisions in the national ethics codes of the G-20 jurisdiction (G-20 benchmarking); and
- Direct interactions with stakeholders to obtain their perspectives about fee-related matters (stakeholder outreach).

She also reminded the Board of the four areas of focus identified in the WG's terms of reference, namely: (i) level of audit fees; (ii) relative size of fees and dependence; (iii) ratio of non-audit to audit fees; and (iv) audit services by firms that have a significant non-audit business.

#### SUMMARY OF ACADEMIC RESEARCH

Dr. Thomadakis and Ms. Kateka welcomed Prof. David Hay, Professor of Auditing, University of Auckland, New Zealand. Prof. Hay noted that his report aims to provide an overview of the risks and concerns

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<sup>12</sup> Proposed Section 340, *Gifts and Hospitality*

identified from his review of academic research studies, and that it was not a comprehensive research project that weighs up all the evidence available. Prof. Hay then presented his findings on each of the four areas of focus.

#### *Level of Audit Fees*

Prof. Hay noted that the main concern relates to the level of fees being set too low, thereby not allowing auditors to undertake their work properly. Whilst the final report cited a study that suggests low fee as an issue in Korea, he has since reviewed more recent studies that indicate otherwise. Prof. Hay nonetheless considered this to be an important issue. He noted one study in 2016 showing evidence that at least occasionally low fees can become a problem. For example, Prof. Hay noted that an area that has been identified by researchers is the existence “low-balling” (i.e., auditors charging unduly low fees) in the case of new engagements. He observed that evidence from studies shows this practice to be associated with both lower quality and higher quality audit. One of the studies seemed to suggest that this is more a concern for private companies where there is not the same level of controls in place or audit oversight such as inspections of audits.

#### *Relative Size of Fees and Dependence*

Prof. Hay reported that some studies note that when auditors charge audit clients fees that are higher than expected, there are perceptions about loss of independence and low audit quality. Prof. Hay pointed out that there are other research papers that associate audits with high fees with high risks, and that there seemed to be consensus that higher fees tend to correlate to higher risks rather than loss of independence.

Prof. Hay identified one study that focused on partners' income based on data from Sweden. He explained that this study demonstrated that for some firms, partners' income, predicted by how they gain or lost clients, had an impact on the partner's professional judgment. Prof. Hay also noted that there were some studies that examined fee dependency at the firm level versus the office or partner level. Prof. Hay summarized that while there is some evidence to suggest some concern, the findings did not consistently identify issues regarding the relative size of fees and dependence.

#### *Ratio of Non-audit to Audit Fees*

Prof. Hay noted that the issue of high level of non-audit fees in relation to audit fees has been widely examined and that all the evidence seems to indicate that high level of non-audit fees in relation to audit fees impacts on an auditor's appearance of independence. Prof. Hay noted that many studies demonstrated a relationship between high level of non-audit fees and market share, and that the most common measure used to evaluate that relationship was the earnings response coefficient (ERC). Prof. Hay explained that the ERC measures investors' reaction in terms of entities' share prices to unexpected public announcements, and that some academic research indicates that the ERC is lower when there is a high level of non-audit services. Prof. Hay also noted that there were other studies with similar results that used measures other than the ERC. Prof. Hay commented that it appears that some investors were able to identify issues that others might not due to lack of sufficient information. He added that in his view, this finding suggests that auditors at least should warn their clients about the potential market reactions that might result from providing non-audit services to audit clients.

Prof. Hay noted that research findings about whether high level of non-audit fees in relation to audit fees leads to lower levels of audit quality and loss of independence were mixed. He observed that the majority of the research findings seem to suggest that this is not a concern.

Prof. Hay observed that there are much fewer studies that analyze fee data post the U.S. Sarbanes-Oxley Act of 2002 (SOX) and that studies that only use post-SOX data also show mixed results. He added that studies focused on both pre- and post-SOX data did not always show significant changes, which seems to suggest that level of non-audit services provided may not have changed since SOX.

*Audit Services by Firms that Have Non-audit Service Business*

Prof. Hay identified two recent unpublished research studies that suggested issues with lower levels of audit quality and reduced appearance of independence as a result of a change in accounting firms' business models (i.e., a business model that involved providing a higher ratio of non-audit versus audit services).

Prof. Hay noted that with regard to the perspectives of stakeholders, he was only able to identify studies relating to investors as discussed in the section above. Further, he did not identify any studies that focus on accounting firms' processes.

*Opportunities for Future Research*

Prof. Hay noted that his final report includes suggestions for future research. In particular, Prof Hay suggested that the IESBA consider conducting a comprehensive meta-analysis with a longer time scale to weigh the findings of all the relevant studies and provide suggested solutions. He also suggested that the IESBA consider undertaking research that involves a review of inspection reports that deal with audit fees, and researching firm data as well as the codes, rules and regulations of other jurisdictions.

Prof. Hay concluded his presentation with a request for the IESBA's approval to use his final report for a submission to the International Journal of Auditing New Zealand. The Board noted no objection.

Among other matters, IESBA participants raised the following matters:

- Some IESBA members questioned the quality of the academic studies reviewed and whether those studies included objective factors. Prof. Hay noted that the published studies cited in the report generally went through a rigorous review process and have the appropriate controls in place. He added that most of the academic studies cited in his report are based on research performed on specific topics, at a point in time. Prof. Hay added that in his view the findings that suggest links between independence in appearance and high levels of non-audit fees were most prevalent.
- Some IESBA members asked for further insights about the use of ERC to measure the market's response to the level of non-audit fees. Prof. Hay observed that sophisticated investors such as business analysts are more likely to be using these measures.
- Some IESBA members questioned whether it was appropriate to infer from academic studies that large and medium-sized firms are more susceptible to have lower quality audits because their business models generally allow for the provision of a higher percentage of non-audit services to non-audit clients compared to audit clients. Prof. Hay noted an academic study which examined the level of fees charged by U.S. accounting firms indicated that the extent of non-audit services provided amongst firms, including the largest four accounting firms, varies. IESBA members observed that it would be useful if this research included data for all firms, and not only the U.S. ones. Some IESBA members were of the view that a different approach is needed to address fee issues for SMPs. Prof. Hay agreed and noted that SMPs are generally under-represented in these studies.
- Some IESBA members observed that at a recent accounting and audit conference, representatives of the U.S Securities and Exchange Commission (SEC) and the Public Company Accounting

Oversight Board (PCAOB) voiced concerns about the impact that accounting firms' provision of non-audit services might have on the quality of the audit. It was suggested that the WG further understand those concerns to determine whether there are ethical issues that warrant further consideration.

- Some IESBA members questioned whether the findings were impacted by the existence or non-existence of TCWG, in particular, audit committees. Prof. Hay responded that the academic studies seem to suggest the existence of audit committees when there are higher levels of audit fees being charged. He also noted that the research suggests that when present, audit committees are likely to demand a certain level of quality.

Ms. Diplock complimented Prof. Hay for his report and presentation. She noted his observations about the findings in the report being varied and therefore inconclusive, and suggested that the International Forum of Independent Audit Regulators (IFIAR) should be approached in order to tap into their wealth of information on fee-related issues and the impact on audit quality.

#### G-20 BENCHMARKING

Ms. Kateka explained that the G20 benchmarking involved a review of the nature and extent of regulatory responses in the G20 countries in relation to the four areas of focus. She added that the WG compared those responses with the standards in the Code.

Ms. Kateka noted that the WG's preliminary view is that whilst the G20 benchmarking did identify some jurisdictions that had more specific requirements relating to fees in comparison to the Code, in principle there were no significant gaps that require immediate attention.

Among other matters, IESBA participants raised the following matters:

- Instead of audit quality, the focus should be on compliance with the fundamental principles in the Code.
- It was suggested that the Code should be aligned with the relevant requirements in the IAASB's standards relating to required auditor communications with TCWG, in particular about fees for audits of listed entities as per International Standard on Auditing (ISA) 260.<sup>13</sup>
- It is important that the Board signal to stakeholders that the concerns that have been raised about fees charged by accounting firms are being explored as part of its current work plan.

Dr. Thomadakis noted that given the different anecdotal information received by IESBA members about the importance of the fees initiative, it is essential that the WG be given the opportunity to gather as much information as possible prior to finalizing its recommendations.

#### WAY FORWARD

Ms Kateka noted the WG is planning to analyze the information received to-date and will also develop an approach for conducting the final stages of its fact finding (stakeholder outreach). The Board asked that the WG provide an update at the March 2017 meeting.

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<sup>13</sup> ISA 260, *Communicating With Those Charged With Governance*

## 8. **NOCLAR**

### PROPOSED RESTRUCTURED SECTIONS

Mr. Fleck briefly introduced the revised drafts of the restructured texts of Sections 225 and 360.

After considering minor editorial changes, the Board approved the texts for exposure with 17 affirmative votes out of the 17 IESBA members present. The ED will be packaged as part of Structure ED-2.

### PROPOSED IESBA STAFF Questions & Answers (Q&As)

The Board considered revised drafts of the IESBA Staff Q&A publications on NOCLAR for both PAPPs and PAIBs. In addition to editorial matters, the following suggestions were made:

- Clarifying the expectation regarding whether the process to reach a decision should be explicitly addressed via firm policies or methodologies as opposed to via guidance.
- Addressing in a more straightforward way the interaction between confidentiality clauses in contracts and the NOCLAR provisions. In particular, while it is clear that PAs must comply with laws and regulations that differ from the Code, it is less clear which prevails in the contractual context. For example, if a contract for a tax service requires confidentiality but the contract also requires that the service must be provided in compliance with laws, regulations and professional standards, whether a firm would have protection with respect to a claim by a client that the confidentiality clause was breached if the firm chooses to disclose NOCLAR to an appropriate authority.
- Whether the NOCLAR provisions would apply to firm personnel who are not PAPPs and not in client-serving roles, for example, IT support, secretaries, janitors, etc.
- Recognizing that legal privilege could apply not only in the context of forensic services but also in the context of other NAS.
- Flagging to stakeholders that additional Q&As could be developed in future based on the experience of the implementation of the new provisions around the world.
- Recognizing the public interest objective served by the NOCLAR response framework in the preamble to the publications.

### WAY FORWARD

The Board asked that staff take the feedback into account and circulate revised drafts of the publications for a fatal flaw review prior to release in early 2017.

## 9. **Strategy Survey**

Dr. Thomadakis introduced the topic, noting that the objective of this session was not to agree the strategic priorities that should feature in the next strategy and work plan (SWP) but to discuss which topics should be included in the strategy survey.

An IESBA member wondered why there was no consideration of resources, budget, etc. Dr. Thomadakis responded that these were not for discussion at this stage but would be considered as part of the development of the draft strategy consultation paper. He then sought views on the approach to, and content of, the proposed survey.

#### APPROACH TO SURVEY

The Board supported the proposed approach to the survey. In relation to stakeholders to whom the survey could be distributed, Board participants provided additional suggestions, including:

- Associations of those charged with governance (TCWG) such as institutes of directors and regional corporate governance organizations.
- Professional and academic ethics organizations.
- Members of the International Organization of Supreme Audit Institutions (INTOSAI).
- Organizations affiliated with IFAC member bodies.
- Other professional organizations not already on the CAG, such as the International Fiscal Association and taxpayer associations.

The Board also encouraged staff to reach out to regions such as Africa and South America that do not often contribute views to IESBA consultations. It was also suggested that consideration be given to promoting the survey to various media within and outside the profession.

#### CONTENT OF SURVEY

In relation to standards-related projects or initiatives, the Board noted a number of commitments that will likely continue beyond 2018 or start in the new strategy period, including professional skepticism, fee-related matters, collective investment vehicles, NAS, and NOCLAR and long association post-implementation reviews. The Board also noted the need to reserve some capacity to address any matters arising from ongoing IESBA coordination with the IAASB regarding topics or issues that overlap both Boards' remits.

The Board then considered a wide range of topics that could be included in the survey, comprising:

- Matters for Board attention identified as part of the Structure and Safeguards projects.
- Matters identified in other current projects for future Board consideration.
- Matters raised by stakeholders.
- Selected matters identified during the previous strategy consultation that did not make it into the current SWP.
- Selected matters identified by the Part C Working Group in its December 2012 final report.

Among other matters, Board participants raised the following comments or suggestions:

- The survey should address trends and developments in the external environment that could create significant new ethical issues for the profession, in particular:
  - Disruptions arising from technological developments and innovation such as data analytics, robotics, artificial intelligence, social networks and cloud computing, which could give rise to questions in areas such as professional competence and due care, professional behavior and confidentiality.
  - Emerging or newer models of service delivery such as managed or outsourced services.
  - Aggressive tax avoidance or tax minimization strategies that raise ethical questions.

- A reconsideration of the definition of a PIE should include consideration of the implications of any changes on how the Code addresses PIEs, e.g., in relation to prohibitions. Nevertheless, any review of the definition should have regard to the fact that jurisdictions have a right to define (and many already do so) the concept of a PIE for their specific purposes.
- Setting aside the potential need for coordination with the IAASB, given that questions have been raised by stakeholders the survey should seek stakeholder views on the merit of a project to clarify the meaning of the concept of the global public interest from the perspective of the Code.
- The description of the topic of materiality should make clear what specific issues have not yet been considered, beyond the clarifications made as part of the Safeguards project.
- Not all the issues may need to be addressed through changes to the Code. Other ways should be explored, including issuance of staff publications and targeted outreach.
- While documentation is important, an over-emphasis on it could detract from the need to apply critical thinking when facing ethical issues.
- Some of the topics identified, such as contingent fees, are very narrow in scope and may not warrant inclusion in the survey, or might be part of broader projects.
- With respect to the topic of breaches of the Code, the survey should explain that it would be a follow-up on feedback received from stakeholders as opposed to a new project addressing breaches.
- The possible topics to include in the survey could be organized under the four strategic themes in the current SWP. In addition, some of the topics might be grouped together as “clarification items” or matters to ensure alignment with IAASB standards.

Some IESBA members noted that a consideration of major trends and developments in the external environment might benefit from a more iterative approach of exploring the implications for the Code through open dialogue with stakeholders. The possibility of developing thought pieces or consultation papers was suggested in this regard.

With respect to the period covered by the next SWP, Dr. Thomadakis flagged that the PC had considered on a preliminary basis the possibility of aligning the IESBA strategy cycle with that of the IAASB, either by starting the next SWP a year later or by extending the next SWP by an additional year. He noted that the PC would further reflect on the matter and bring forward a recommendation to the Board in due course.

#### WAY FORWARD

The Board asked that the PC present the draft strategy survey for consideration at the March 2017 meeting with a view to issuance by the end of Q1 2017.

#### 10. **PIOB Observer's Remarks**

Ms. Diplock congratulated the Board and its staff on the progress made during the meeting. She observed that the public interest was an overarching consideration during the deliberations and that she was impressed with the strength of commitment and energy and the determination to ensure the standards are appropriate in the public interest.

In response to the concerns raised by some IESBA members about the PIOB's involvement in finalizing the LA project, Ms Diplock commented that there is an ongoing discussion about what should constitute the PIOB's oversight role and what involvement, if any, the Monitoring Group (MG) should have. She noted

a philosophical view that due process is all about the steps taken and that the output will be appropriate if all the steps have been followed. She noted that the PIOB view is also about whether the standard is of a quality that it feels it can approve in the public interest. She felt that this philosophical distinction was perhaps what was reflected in the Board discussion earlier.

Ms. Diplock reported that the PIOB was now reviewing the responses to its [2017-2019 Strategy Consultation Paper](#). She added that the MG is confident that the PIOB will step forward if for some reason it considers a final standard to not be in the public interest.

Dr. Thomadakis thanked Ms. Diplock for her remarks and added the IESBA will be interested in the outcome of future discussions about the PIOB's role as it relates to overseeing the SSBs.

#### **11. Next Meeting**

The next Board meeting is scheduled for March 13-15, 2017 in New York, USA.

#### **12. Closing Remarks**

On behalf of the Board, Dr. Thomadakis bid farewell to retiring IESBA members Ms. Ighodaro and Mr. Kato as well as Mr. Bromell, thanking them for their contributions to the Board's work.

Dr. Thomadakis also thanked IESBA participants for their contributions to the meeting and conveyed his best wishes for the holiday season. Finally, he thanked IFAC for hosting the meeting and for its administrative support. He then closed the meeting.