Agenda Item
F-1

Structure of the Code—Preliminary Report and Recommendations

Introduction

1. This preliminary report presents the IESBA Structure of the Code Working Group's findings and recommendations to the Board on how the Board might address ways to improve the usability of the *Code of Ethics for Professional Accountants* (the Code), thereby facilitating its adoption or convergence with it, effective implementation and consistent application.

2. The recommendations in this report, with the exception of those in respect of "Responsibility," are not intended to modify the content of the Code's provisions; but modification may to some extent be inevitable, if unintentional, if words and structures are changed. Any changes would be subject to the agreement of the Board and appropriate due process.

3. The IESBA's objective is to serve the public interest by setting high-quality ethics standards for professional accountants and by facilitating the convergence of international and national ethics standards, enhancing the quality and consistency of services provided by professional accountants throughout the world and strengthening public confidence in the global accounting profession.

4. The IESBA has in the past received feedback on the clarity and usability of the Code. For example, regulators have provided comments on enforceability, and an IFAC Small and Medium Practices (SMP) Committee survey stated that the biggest barrier faced by SMPs in fully adhering to the Code is understanding the requirements of the Code. The Board has also received comments on difficulties in translating some parts of the Code, and understanding complex and long sentences in the Code. Some of these issues relate to the usability of the Code and may be impacting adoption and implementation.

5. In 2012, the IESBA began to consider how it might improve the structure of the Code to raise the visibility of its requirements (Visibility), and clarify who is responsible for meeting them (Responsibility). In December 2012, the Board established a Working Group to identify and recommend to the Board ways to improve the usability of the Code, thereby facilitating adoption or convergence, effective implementation and consistent application. The Terms of Reference noted the following:

   - The Working Group will focus in particular on drafting conventions, format, structure, and delivery media taking into account impediments identified by stakeholders.

   - The Working Group will develop and validate findings and recommendations based on research and communication with stakeholders.

   - Timely reporting to the IESBA will be important to enable the IESBA itself to be suitably responsive.

6. The research addressed whether there is a case for change and, if so, the nature of any changes that may be necessary.

7. The findings indicate a broad-based appetite for change. There is widespread support for increasing the visibility of requirements and clarifying the language in the Code on a timely basis. There is also support for, but less urgency associated with, developing a repackaged and electronic Code, and for complementary materials to help users better understand the Code.

Information Sources

8. In order to gain additional insights into the challenges faced by professional accountants, regulators and member bodies, the Working Group researched the views of a broad range of stakeholders. The research provides a basis for the Working Group recommendations and any resulting IESBA action. This action will be further validated if and when the board exposes proposed changes.

9. The Working Group members interviewed, or sent interview questions to, stakeholder representatives from Europe, Australasia, Asia, North and South America, and Africa. Stakeholder groups included regulators, the IESBA-National Standard Setters (NSS) Liaison Group and IFAC member bodies. The questions addressed those matters on which the Working Group was seeking input and did not cover a reconsideration of the requirements in the Code.

10. Between June and October 2013, the Working Group obtained input from 32 participants, including a consolidated response in respect of the European profession. Input has been obtained from some members of the International Forum of Independent Audit Regulators (IFIAR), and the International Organization of Securities Commissions (IOSCO) provided a number of suggestions of relevance to this initiative in its comment letter responding to the January 2013 IESBA strategy survey.

Working Group Findings and Recommendations

11. The Working Group's findings and recommendations are set out in the following pages for the Board's consideration. Most of the issues and recommendations are inter-related and there are advantages in considering the recommendations collectively as well as individually. For example, some structural issues and comments on the length of the Code may be mitigated by an electronic Code.

I. Distinguishing Requirements from Guidance

12. A number of research participants expressed the view that mixing requirements with guidance causes problems for users. Users have difficulty understanding the provisions of the Code because "there is a long preamble so the main point is buried somewhere further down." Regulators questioned the enforceability of the Code because requirements are not separate from guidance. Failure to distinguish requirements from guidance may have been a barrier to adoption in some jurisdictions.

13. Distinguishing requirements may also allow legislators to extract relevant text from the Code and adopt it in legislation.

14. It is in the public interest for the Code to be understandable by professional accountants and enforceable by regulators. Some IFAC member bodies and regulators were comfortable working with the Code without separation of requirements, but the Working Group identified widespread support for distinguishing requirements. The importance to regulators of distinguishing requirements from guidance was demonstrated by the research.

15. Distinguishing requirements from guidance can be undertaken within the threats and safeguards framework. Requirements include the requirement to apply the conceptual framework (the threats and safeguards approach) as described in paragraph 7 of Section 290 of the Code.[1]

16. Grouping all requirements separately from guidance was not thought helpful as it may impede due consideration of the guidance.

Recommendations

17. The Working Group recommends:

- Separation of requirements from guidance.

- Clearly identifying application of the conceptual framework (the threats and safeguards approach) as a requirement.

- Presentation of guidance adjacent to the relevant requirements.

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[1] Section 290, *Independence – Audit and Review Engagements*

II. Prescribing Specific Responsibility of Individuals in Section 290

18. Section 290 does not, in most cases, prescribe the responsibility of individuals within the firm related to independence because responsibility may differ depending on the size, structure and organization of a firm. Examples of requirements that are not specific to an individual (they may refer to a firm or use the passive voice) include the following:

- A firm shall identify and evaluate threats to independence. (290.10)

- In evaluating the significance of a threat, qualitative as well as quantitative factors shall be taken into account. (290.11)

19. The Working Group noted that the clarity of responsibility varies in the Code. Section 290 includes 154 "shall statements" or requirements:

Responsibility	# of "shall" statements?	Comment
Passive Voice, where the responsibility is not defined and would require guidance from the IESBA.	69	It is not possible to infer who is responsible for undertaking the "shall" statement. Most examples are: • "An evaluation shall be made of the significance of any threats"; or • "safeguards shall be applied to eliminate the threat"
Passive Voice, where change to the active voice would not change the meaning.	16	It is possible to infer who is responsible for undertaking the "shall" statement. The passive voice appears to be unnecessary.
Firm	42	Clearly states that the "Firm" is responsible. Ambiguity may arise as firm includes network firm (paragraph 290.3). It may be unclear which individual is responsible in a complex firm.
Professional Accountant	5	Although professional accountant includes a firm (Definitions), four instances relate to documenting and one is a principle. Appears to be clear.
Audit Team	5	The definition of "Audit Team" is sufficiently broad that it would be difficult to identify who within the team is responsible; although the paragraphs in 290 are clear in identifying it is the audit team that is responsible. "Team" implies a group who work together although the definition includes a chain of command up to Chief Executive.
Lists of persons	8	Responsibility is clear

Responsibility	# of "shall" statements?	Comment
The individual	4	Responsibility is clear
Miscellaneous	5	Responsibility is clear
TOTAL	**154**	

20. The Working Group considered whether Section 290 is sufficiently precise to enable professional accountants to comply with, and regulators to enforce, the responsibility of individuals within the firm for actions related to independence. It also considered whether circumstances warrant recommending that the IESBA reconsider its 2007 view that with a global code and the wide variety of circumstances faced it is not practical to define who is responsible for a particular action. As noted above, it is in the public interest for the Code to be understandable by professional accountants and enforceable by regulators.

21. The research identified that regulators believe the enforceability of the provisions of the Code should be a priority. From an enforcement perspective, it helps to be able to hold individuals to account. This research and comment letters on past exposure drafts identify concern that not prescribing the responsibility of individuals within the firm related to independence poses challenges in terms of the Code's enforceability and therefore its wider adoption. One response from within the profession stated: "another issue that could be considered is to make sure that each provision clearly indicates who is exactly addressed by the requirement therein. For instance, it is currently not always clear if a requirement relates to individual professional accountants, firms or network firms." The research also identified that some respondents do not believe that any change is necessary because, amongst other matters, the engagement partner is automatically held responsible, or ISQC 1[2] or legislation addresses the matter.

22. Paragraph 290.12 of the Code states the following (underline emphasis added):

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

23. The Independence 1 exposure draft (December 2006) proposed:

    This section does not prescribe the specific responsibility of individuals within the firm for actions related to independence because responsibility may differ depending on the size, structure and organization of a firm. Accordingly, firms should have policies and procedures, appropriately

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

documented and communicated, to assign responsibility for (a) identifying and evaluating threats to independence and (b) applying appropriate safeguards to eliminate any threats or reduce them to an acceptable level.

24. The IESBA view as stated in October 2007 is that with a global code and the wide variety of circumstances faced it is not practical to define who is responsible for a particular action. ISQC1 requires firms to have policies and procedures to provide reasonable assurance that independence has been maintained. In addition, ISA 220[3] requires the engagement partner to form a conclusion on compliance with independence requirements that apply to the audit engagement.

25. This view, reflected in the Code, has continued to cause concern, especially among regulators.

Recommendation

26. The Working Group recommends the following:

- For "Passive Voice, where the responsibility is not defined and would require guidance from the IESBA," add a sentence to strengthen paragraph 290.12.

- For "Firm", add a sentence to strengthen paragraph 290.12.

- For professional accountant, lists of person, "the individual" and miscellaneous, no change to the Code because the responsibility is clearly defined.

- For "Passive Voice, where change to the active voice would not change the meaning" change the wording to the active voice.

The additional sentence in paragraph 290.12 would clarify that a firm should have policies and procedures that enable identification of the individual responsible for maintaining independence in a particular circumstance.

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3   ISA 220, *Quality Control for an Audit of Financial Statements*, paragraph 11

III.   Clarity of Language

27.   Some users, especially those whose first language is not English, have reported difficulty in understanding the Code, especially the long and complex sentences. NSS and IFAC member bodies that translate the Code have commented similarly. For example:

- The Code's definition of certain words to mean something other than their standard definition is confusing and leads to misinterpretation of the Code, e.g., audit means "audit or review".

- Some terms without common understanding, e.g., "closely held entities," are used in the Code without definition.

- Readability is not helped by use of stock phrases such as "the professional accountant in public practice." Avoidance of gender specific pronouns has led to cumbersome sentence structure and repetition of stock phrases.

28.   The comprehension difficulties appear to be mainly in the Independence sections.

29.   Although portions of the Code may be difficult to read, the drafting conventions are rigid, so the meaning can generally be understood with sufficient research. The Working Group does not believe that rigor requires long and complex sentences. It is possible to convey complex issues clearly.

30.   Translation would be facilitated if the Code's use of terminology would take into account the fundamental different approach to some legal concepts by common law and civil law jurisdictions. For instance, the Code commonly refers to "trusts," a concept which although understood in common-law jurisdictions, do not exist in most civil-law jurisdictions, which have alternative vehicles.

31.   The "drafting conventions" project in 2008 focused on using consistent terminology of important terms in the Code, e.g., "shall," "clearly insignificant," "acceptable level," "consider," "evaluate," and "determine." While facilitating consistency, it did not provide rules or principles that result in plain English. Further, no drafting conventions have been provided to staff, Task Force members or Board members to ensure consistent drafting.

Recommendations

32.   The Working Group recommends:

- Increasing the clarity of language by, amongst other things:

    o   Reducing the reading age of the Code through revised drafting conventions, which would extend beyond consistent use of specific terms (shall, consider etc.) and include clarity of language and translatability as objectives. The drafting conventions should include an aspirational reading age for the Code, or sections of the Code.

    o   Developing and providing to all Board members and staff drafting conventions which facilitate the style of English favored by the Board.

    o   Scrutinizing the text for duplications which cloud the meaning of the provisions. Currently, certain concepts and wordings are frequently repeated, such as the conceptual framework contained in Part A. This model requires a professional

accountant to identify, evaluate and address threats to compliance with the fundamental principles. The entire wording of the conceptual framework is then used repeatedly in parts B and C of the Code. This reiteration could be circumvented by stating the conceptual framework in one general article and referring back to that provision in all subsequent relevant situations.

- o Avoiding linguistic nuances to finesse challenging issues. Although the nuance may be understood by the Board it may be misunderstood outside the Board.

- o Using more sub-headings and an improved contents list to help users find relevant sections.

- Using an editor responsible for clarity of language, who is knowledgeable but detached from the project.

- Considering the translatability of exposure drafts during drafting. Using multi-lingual Board members is one possible way. This is of particular relevance for those languages into which the Code has been translated and where it has been adopted.

IV. Electronic Code

33. The Code is currently available in a PDF version in addition to the printed handbook. Further developments can be envisaged, including hyperlinks, interactive search facilities ("other users who searched this also searched this," etc.), and a mobile app.

34. Packaging the Code for different users either as part of, or instead of, an electronic code would allow sections of the Code to be structured to present only the relevant sections to users. This would make the Code more relevant to users and reduce the apparent length by enabling the omission of content irrelevant to their needs.

35. Respondents to the research did not rate an electronic Code as a high priority. Many IESBA members, however, felt that an electronic Code would be key to addressing the issue of accessibility and, if developed in an innovative way, may help users better understand the Code. An electronic Code may enable packaging and navigability features that enhance usability. Considering electronic features in conjunction with changes to the structure of the Code enables a coordinated approach.

36. An electronic Code may, for example, enable a user to easily combine or separate standards for audits, reviews and other assurance engagements by ticking a box when accessing the Code. A version focused on only one type of engagement may be appropriate for a professional accountant focused on a particular assurance engagement and a regulator with a mandate covering only one type of service (e.g. audits); a version addressing all services in an integrated manner may be useful for practitioners considering independence for a range of services, and standard setters, independence advisors and enforcement bodies with a mandate covering all types of assurance services.

37. The Board would need to decide if at some point the electronic version would be the "official" version.

Recommendations

38. The Working Group recommends:

- Considering immediate improvements if achievable with limited resources:

  o Developing hyperlinks between defined terms and their definitions.[4]

  o Improving navigation between sections of the Code to help users find the Sections relevant to their needs.

- Coordinating more extensive electronic features with other changes to the structure of the Code. This will avoid investing in changes based on the extant Code, if significant changes to the structure are subsequently made. At that time, changes should take into account expected usage of the electronic Code and advice from web experts on how best to take advantage of current trends and technology, e.g., apps, wikis, MOOCs[5] etc. Identified needs include:

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4   This technique could also be applied to the paper version of the Code, using asterisks or similar.

5   Massive Open Online Courses

o   Filtering that enables only those portions of the Code relevant to the user to be presented.

o   Definitions readily accessible through links or hovering.

o   Enhanced navigation.

o   Enhanced search functionality.

o   That a printed version of the Code remain the official version for the foreseeable future.

V.   Repackaging

39.   Issues warranting repackaging of the Code may be mitigated by an electronic Code. Therefore the comments and recommendations to repackage the Code, and their importance and urgency are combined with those for an electronic Code.

40.   Section 291[6] duplicates much of what is in Section 290 and therefore significantly increases the length of the Code. The benefit of having them separate is to allow a clear focus on the requirements that apply to each. An alternative approach is to split Independence into three sections: audit of public interest entities, audits and reviews of other entities, and other assurance engagements.

41.   In progressing adoption and implementation it may be worthwhile to put more immediate emphasis on the independence standards in the Code. Many countries have already integrated ethical provisions, other than independence, in their national legal instruments. Therefore, attempting to get all provisions, both ethical and independence, from the Code adopted is more difficult but independence is an area in which significant progress can be made.

42.   Repackaging the Code can make it more relevant to users other than those who provide audit and assurance services because the parts of the Code relevant to Independence overshadow the other parts that apply to all other professional accountants. It may make the Code more relevant to regulators who are only interested in audit to focus on those parts that are relevant to them.

43.   An electronic Code would address comments on the length of the Code and provide greater flexibility to tailor the Code. Each section could be replicated to allow the user to identify only the text that applies to their needs, for example, as an auditor of a public interest entity (PIE), a reviewer, and a provider of assurance services. Therefore, it may be wise to take a decision on the repackaging of the Code in conjunction with a decision on an electronic Code.

Recommendations

44.   The Working Group recommends:

- Repackaging in conjunction with an electronic Code.

- Moving Independence (Sections 290 and 291) into a separate area within the Code. Its length is out of proportion to the rest of the Code compared to Parts A and C.[7] The independence document would be a sub-set of the Code and would be clearly linked to the rest of the Code. However, a more navigable electronic Code could be designed to only present Sections 290 and 291 to those that need to use it. These sections can be easily made stand-alone and read on their own, which may make the Code easier to digest for professional accountants who are not involved in assurance engagements. A separate independence section will emphasize that all assurance services are subject to the independence requirements, even if those are not statutory audits. This is especially important in light of the increase of external assurance services on non-financial information,

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[6]   Section 291, *Independence – Other Assurance Engagements*

[7]   Part A, *General Application of the Code*, and Part C, *Professional Accountants in Business*

such as sustainability reporting. A focus on independence may add to the reliability of these services by professional accountants and increase the confidence of the regulators and the public.

- Branding Sections 290 and 291 with a term such as International Standards on Independence (with appropriate material from Part A and Section 200 referenced), differentiating clearly between the requirements for PIEs and entities that are not PIEs. This would facilitate users' finding relevant sections/standards and be consistent with the practice of other standard setters.

VI. Complementary Materials

45. The research identified that a principles-based code is sometimes difficult to understand without supporting explanations if the user is not familiar with the Board's deliberations in the drafting of the Code. Users in less developed economies, small and medium practices (SMPs) and professional accountants in business may have limited access to, or limited resources for, training that would help enhance understanding of the Code. The research responses included the comment "IESBA is too precious about the integrity of the code and it can produce more guidance outside of the code, which should concentrate on principles and policies." However, there may be a risk that users confuse the boundary between the Code and off-Code guidance. It would be necessary to avoid accidentally extending a "quasi-Code" into new requirements.

46. The need for complementary materials may be mitigated by changes to the structure of the Code and work on them, if any, should commence after any changes to the structure of the Code are finalized and the need has been re-assessed. They are therefore less important and urgent than visibility, responsibility, clarity of language or an electronic Code.

47. Complementary materials do not change the wording of the Code and do not require formal due process. They could be developed either in parallel with changes to the clarity of the Code or subsequently.

48. Short summaries could be developed within the Code for each Section of the Code, explaining the objective of the Section or as part of a drill down approach in an Electronic Code, or both.

49. Advantages of other complementary materials are that they:

• Do not disrupt the Code.

• Can be useful aide-memoires for users.

• Can be useful to promote the Code to regulators.

• Can be useful tools for training materials for educators.

• May make the Code accessible to those who otherwise would not read it.

50. Challenges to be addressed in using other forms of complementary materials are:

• The risk of them being used instead of the Code, potentially resulting in important details in the full Code being missed.

• Blurring the boundary between the Code and complementary materials.

• The need for a process to evaluate complementary material produced by others and to which the Code could be linked and the extent to which a link could be interpreted as endorsement by IESBA of third party materials.

51. Complementary materials may provide possibilities for outreach and interaction with a broader group of stakeholders than currently use the Code.

Recommendations

52. The Working Group recommends:

• Addressing complementary material after the restructuring of the Code.

- Considering working with others to develop materials or take advantage of existing materials already developed by others, for example, case studies prepared by member bodies. This could rapidly increase the content available to users with a low resource commitment from IESBA staff.

53. Examples of complementary materials are listed below in order of priority:

- Short summaries of the Code. The High Level Summary of Prohibitions Applicable to Audits of Public Interest Entities issued in 2012 has been found to be helpful in communicating with regulators and other stakeholders. Similar summaries may also be helpful as an introduction or overview of the Code for professional accountants and others, prior to in-depth research of the Code. The need for summaries may be reduced if incorporated in an electronic Code.

- Frequently-asked questions (FAQs) have already been issued by IESBA. More may be helpful, as appropriate.

- Case studies on ethics issues, linked to the Code have been prepared and issued by member bodies.

- Comprehensive bases for conclusions, explaining the intent of each paragraph of the Code may be helpful, although users can derive the reason for many paragraphs of the Code by using the explanatory memorandum and basis for conclusions. Comprehensive bases for conclusions would require significantly more resources.