

**Meeting:** IESBA CAG

**Meeting Location:** New York

**Meeting Date:** March 10, 2014

## Agenda Item

# F

### Structure of the Code

#### Objective of Agenda Item

1. To:
  - (a) Obtain feedback from CAG representatives on the Structure of the Code Working Group's preliminary report and recommendations;
  - (b) Obtain support for further work on the application of the recommendations to Section 290;<sup>1</sup> and
  - (c) Review key matters identified in the project proposal to be discussed by the IESBA at its April 2014 meeting.

#### Project Status and Timeline

2. In February 2012, the IESBA agreed to consider how it might improve the structure of the Code to raise the visibility of the requirements and prohibitions in the Code, and clarify who is responsible for meeting them (Responsibility). Also, various stakeholders have commented on issues associated with the structure, format and clarity of the Code. Some of these issues relate to the usability of the Code and may be impacting adoption and implementation.
3. The Working Group (WG) was formed in January 2013. The WG presented a status report summarizing its research plans and Terms of Reference at the June 2013 IESBA meeting. The Terms of Reference were approved. The research addressed whether there is a case for change.
4. The CAG considered the initiative in April 2013 and September 2013.
5. The Working Group analyzed the research findings and presented its preliminary report and recommendations, taking into account input received from the Board and the CAG, to the IESBA in December 2013. For information, the draft minutes of the IESBA discussion are included as Appendix A.
6. To facilitate timely attention to the Working Group's recommendations, a staff member from the Institute of Chartered Accountants of Manitoba, Shirley Sommer, was engaged to provide additional staff support. Ms. Sommer has experience developing independence standards in Canada that are converged with the IESBA Code and that separate requirements from guidance.

---

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

## September 2013 CAG Discussion

7. Below are extracts from the draft minutes of the September 2013 CAG meeting,<sup>2</sup> and an indication of how the WG or IESBA has responded to CAG Representatives' comments.

Representatives' Comments	Task Force Response
GENERAL COMMENTS	
Mr. Kockvedgaard suggested that a general overview or a summary of the purpose of each section and what issues it addresses, before the detailed provisions, would help users not familiar with the Code (such as investors) to better understand what the section is seeking to achieve.	Mr. Thomson noted that this was consistent with the WG's thinking, adding that structuring the Code in a logical format can help achieve much progress.  Point accepted. A scope paragraph and a purpose paragraph are included in the examples of a restructured Code.
Ms. Blomme expressed support for the initiative and its direction, noting that the preliminary research findings are consistent with comments from those EU jurisdictions that are looking at what can be done in terms of enhancing the Code's usability.	Mr. Thomson thanked FEE for its input to the project research, noting that the input was consistent with the WG's thinking.  Support noted by the WG.
ELECTRONIC CODE AND REPACKAGING	
Mr. Ratnayake asked what type of electronic code is envisioned.	Mr. Thomson noted that the idea was to provide users with the flexibility to drill down into the Code and perform such tasks as sophisticated searches, etc. He noted that no decisions had been made and the WG would consider the matter further.  Point noted by the WG. The WG will explore further the Electronic Code options.  An electronic Code in an HTML format with navigation from the landing page to each individual section and with links from all defined terms to the definition is planned.
Ms. Lang wondered if the WG had considered dialogue with stakeholders in terms of how the Code could be used and repackaged. She felt that if jurisdictions have already repackaged the Code for their specific circumstances, a repackaged Code may not have any significant effect for them.	Mr. Thomson noted that the WG had indeed engaged in dialogue with stakeholders to understand their different perspectives on this matter. While the WG was expecting a significant degree of opposition to changes to the Code, this did not materialize. Instead, stakeholders were

<sup>2</sup> The minutes will be approved at the March 2014 IESBA CAG meeting.

<p>However, if the repackaging were aimed at those who do not use the Code, then the effort would be worth undertaking. Accordingly, she highlighted the need to consider the costs and benefits of repackaging.</p>	<p>supportive of, and open to, changes being made to the Code. Therefore, generally the cost of repackaging was not felt by stakeholders to be a significant issue.</p> <p>Point noted by the WG.</p>
<p>Mr. Hansen wondered to what extent an e-Code would address Ms. Lang's question regarding level of acceptance of the Code. He noted that most standard setters have their own standards on the web, and it would be odd if IESBA did not move in that direction.</p>	<p>Mr. Thomson noted that respondents did not necessarily indicate that an electronic Code is not appropriate but it was less of a priority for them compared with other issues such as the visibility of the requirements. He noted that in practice many users would more likely consult their national ethical codes than the IESBA Code.</p> <p>Mr. Holmquist noted that an electronic code might be a way of presenting the Code in a wholly different light and represent a wholly different way in which it could be used.</p> <p>Point accepted by the WG.</p> <p>An electronic Code in an HTML format with navigation from the landing page to each individual section and with links from all defined terms to the definition is planned.</p>
<p>Mr. Ratnayake asked how jurisdictions that include the Code in the law would "gazette" the Code if it were electronic.</p>	<p>Mr. Thomson noted that he would still envision a printed version of the Code. The question, however, would be which version would be the official one. Nevertheless, he recognized that the format would need to enable different jurisdictions to adopt the Code.</p> <p>The WG does not envisage that an electronic Code would replace a paper Code in the foreseeable future.</p>
<p>Mr. Koltvedgaard wondered if an evaluation of the reading grade of the Code could be done electronically, and if it would be possible to identify those paragraphs most in need of attention.</p>	<p>Mr. Thomson noted that this could be done, although he suspected that the reading grade would be consistently high. Mr. Holmquist noted that this could be a good process suggestion in terms of having task forces put their draft changes to the Code through a reading grade system.</p> <p>Point accepted by the WG.</p> <p>As noted by Mr. Thomson in the meeting, it is thought that the reading grade would be</p>

	consistently high throughout the Code, in particular in the Independence section. The reading grade is likely to be more useful as an aspiration for drafters of the Code than to be used as a strict rule. The WG tentatively proposes an aspirational reading grade of 15, using the Flesch-Kincaid tool in Microsoft Word.
PLAIN ENGLISH	
Mr. Morris expressed interest in the idea of reading grade levels for the Code and wondered whether the WG had thought about a particular reading grade to aim for. In particular, he questioned the impact on the length of the Code if a lower reading grade were achieved.	Mr. Thomson noted that the reading grades could help establish a discipline when drafting sections of the Code and that while it was unclear at this stage whether the IESBA should set a specific target, the IESBA could aspire to a lower reading grade. He noted that the examples in the agenda material were intended to prompt questions, such as the use of “you” in plain English drafting.  Point accepted by the WG. See also comments above.

#### **Matters for CAG Consideration**

##### **A. PRELIMINARY RECOMMENDATIONS**

8. The WG presented its preliminary recommendations to the IESBA in December 2013. These recommendations are presented as Agenda Item F-1.
9. The IESBA expressed broad support for the direction of the WG’s proposal to distinguish requirements from guidance to enhance understandability and enforceability but asked the WG to take note of the cautions expressed by IESBA members (see draft minutes in Appendix A).
10. The WG proposed requiring that a firm establish policies and procedures that enable the identification of the individual responsible for maintaining independence in a particular circumstance. The IESBA agreed to defer a final decision on whether to address the matter of responsibility as part of the Structure initiative or as a separate project until it has considered the WG’s final recommendations at the April 2014 IESBA meeting.
11. IESBA members broadly supported the WG’s proposals to increase the clarity of language in the Code. The IESBA asked the WG to present its final proposals in this area at the April 2014 IESBA meeting.
12. With respect to an electronic Code, the WG proposed and the IESBA tentatively supported:
  - Exploring immediate enhancements in terms of electronic features if achievable with limited resources;
  - Coordinating more extensive electronic features with other changes to the Code’s structure; and

- Maintaining the printed version of the Code as the official version for the foreseeable future.
13. With respect to repackaging the Code, the WG proposed and the IESBA tentatively supported:
- Repackaging in conjunction with an electronic Code;
  - Moving independence into a separate area within the Code provided it is clearly a subset, and linked to the rest, of the Code; and
  - Considering whether to rename the Code and/or the independence standards to raise their profile and enhance the brand.
14. With respect to complementary materials, the WG proposed and the IESBA tentatively supported:
- Addressing the matter of complementary material after restructuring the Code as the restructuring may eliminate the need for some material; and
  - Considering working with others to develop material or taking advantage of existing material already developed by others.
15. Illustrative examples of a possible approach to restructure Sections of 290 are presented as Agenda Item F-3 (mark-up) and F-4 (clean).
16. With respect to the illustrative examples of a possible approach to restructure Sections of 290, IESBA members tentatively supported the general approach taken in the illustrative examples of certain restructured sections of the Code. In particular, there was some support for the proposed flow of each section, i.e., comply with the conceptual framework; set out specific threats and safeguards; and set out those areas where the threat is so great that a prohibition would be appropriate. There was also support for a short statement of purpose at the beginning of each section.

#### **Matters for CAG Consideration**

1. Representatives are asked for any comments or questions on the preliminary recommendations:
  - To distinguish requirements from guidance.
  - To require a firm to establish policies and procedures that enable the identification of the individual responsible for maintaining independence in a particular circumstance.
  - With respect to increasing the clarity of language in the Code.
  - With respect to an electronic Code.
  - With respect to repackaging the Code.
  - With respect to complementary materials.
  - With respect to the general approach taken in the illustrative examples of certain restructured sections of the Code.
2. Representatives are asked if they support further work on the application of the recommendations to Section 290
3. Representatives are asked for feedback, if any, on the project proposal.

B. UPDATED STATUS REPORT ON RESEARCH UNDERTAKEN

17. In September 2013, the IESBA received the Structure of the Code WG's preliminary analysis of research findings regarding ways to improve the usability of the Code and to determine whether there is a case for change. In December 2013, the IESBA received an updated report that incorporated some additional responses. The updated report is presented as Agenda Item F-2.

**Material Presented – CAG Paper**

Agenda Item F-1	Preliminary Recommendations
Agenda Item F-2	Updated Status Report on Research
Agenda Item F-3	Possible Approach to Restructure Subsections of Section 290 (mark-up)
Agenda Item F-4	Possible Approach to Restructure Subsections of Section 290 (clean)
Agenda Item F-5	Project Proposal

## Appendix A

### **Draft December 2013 IESBA Minutes – Structure of the Code**

Mr. Thomson introduced the topic, providing background to the initiative and outlining the work undertaken by the Working Group (WG) to date. He then presented the WG's preliminary report and recommendations based on its research findings and the input received from the CAG and national standard setters.

#### **DISTINGUISHING REQUIREMENTS FROM GUIDANCE**

The WG proposed to distinguish requirements from guidance to enhance understandability and enforceability. This would include clearly identifying the application of the conceptual framework (the threats and safeguards approach) as a requirement.

Among other matters, IESBA members made the following comments:

- If the intention is not to turn the Code into a set of rules, it is unclear how distinguishing requirements from guidance would increase the enforceability of the Code. Mr. Thomson noted that regulators had indicated that the Code would be more easily enforceable if the requirements were clearly demarcated from the guidance. He noted that the Canadian Public Accountability Board (CPAB) had expressed concern about this issue when Canada considered adopting the 2009 Code. He also highlighted that separating requirements from the guidance would facilitate the adoption of the Code into law.
- It is important not to take a strictly legalistic view of enforceability as regulators are able to set rules to meet their specific needs. Instead, it is important to bear in mind that a code of ethics transcends laws and regulations. If the aim is to influence the PA to act more ethically, the Code should provide appropriate guidance to achieve that aim. In this regard, it was noted that in litigation the prosecutor or the court would consider the totality of the Code, including what is in guidance, in making a case.
- Legislation that is broadly based is as enforceable as one that is rules-based. Common law jurisdictions tend to have principles-based laws that are enforceable but this requires judgment as well as the application of a standard of care and diligence. Understanding this is important when thinking about enforceability.
- It would not be appropriate to start a section with a prohibition without explaining why the prohibition is important. Accordingly, there is a need for a logical flow starting with an analysis of the threats and safeguards.
- Regulators in some jurisdictions are unfamiliar with the threats and safeguards approach and tend to gazette the requirements as opposed to the guidance. Accordingly, when developing the requirements, it would be important to make the requirements self-contained.
- Care should be taken in drawing a parallel with the International Standards on Auditing (ISAs) because auditing standards tend to be sets of procedural requirements supported by guidance. In contrast, ethics standards need to provide assistance to help professional accountants (PAs) rationalize why something is a requirement. Accordingly, care should be taken in separating the requirements from the guidance.

Mr. Sylph advised against the use of bold and gray lettering, and emphasized the importance of making clear that the requirements must be read in conjunction with the application material. It was, however, noted that Australia has taken the bold and gray lettering approach in its ethics standards and that this approach appears to work well in practice.

Mt. Koktvedgaard emphasized the importance of making the requirements clear and the steps needed to achieve independence. As is the case for the ISAs, he was of the view that some of these steps might not necessarily be applicable in all circumstances, for example, if engagement team members have no financial interests in the audit client.

After further deliberation, the IESBA expressed broad support for the direction of the WG's proposal but asked the WG to take note of the cautions expressed.

#### **PRESCRIBING RESPONSIBILITY OF INDIVIDUALS IN SECTION 290<sup>3</sup>**

The WG proposed requiring that a firm establish policies and procedures that enable the identification of the individual responsible for maintaining independence in a particular circumstance.

The Board considered whether the Code should include, as a defined role, an ethics partner with a senior position and access to firm leadership. While not arguing that every firm should have an ethics partner, an IESBA member expressed the view that the Code should include a provision for a firm to assign responsibility for ethics to a partner with direct access to the firm's leadership, similar to the approach taken in the independence standards issued by the UK Financial Reporting Council. It was argued that this would enable ethics to be given the appropriate level of importance by firm leadership. However, it was recognized that it may be difficult to assign responsibility to only one individual as a variety of individuals are often involved in practice.

A few IESBA members expressed support for identifying an individual who can be accountable for ethics, noting that when responsibilities are diffuse, issues may not be appropriately addressed. In addition, it was felt that when the Code refers to the firm, it is unclear who in the firm has the specific responsibility. Another IESBA member, however, felt that whether it is appropriate to allocate responsibility for all the firm's ethics matters to one individual is a fundamental issue that would require significant analysis. The IESBA member also felt that the issue is not necessarily a structure issue but one that fundamentally concerns how quality control within a firm should be addressed.

Other IESBA members made the following comments:

- Some firms may be too small to have an ethics partner but whoever has responsibility should have access to the firm's leadership.
- In some circumstances, it is necessary to mention the individual's responsibility; for example, if an engagement team member receives a financial interest through inheritance, it would be the individual's responsibility to communicate the matter to the firm. It is therefore not necessary to assign responsibility to the firm in every situation.
- There is a risk that identification of a responsible individual may facilitate enforcement action against that individual when other individuals may be responsible for the particular breach. However, it was argued that allocating responsibility to specific individuals would not necessarily

---

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



preclude prosecutors from pursuing enforcement action against others in the firm who can be held liable. It was noted in particular that a court of law would consider who should bear liability in the case and that this would depend on the specific circumstances, regardless of what the Code states.

- The matter of assigning responsibility is a substantive issue that should be addressed separately to avoid slowing the work on structure.
- Using the active voice would require specifying a subject in the sentence, which would force the allocation of responsibility. It would therefore be necessary to be careful that the responsibility is allocated appropriately.

Mr. Koktvedgaard expressed the view that the Code should be more direct in terms of assigning responsibility because if it is unclear who should bear responsibility, regulators would not be able to enforce the Code. A few IESBA members, however, disagreed with this view, noting that while the Code can specify that firms should assign responsibility, it would not be appropriate for the Code to specify who precisely should bear that responsibility. It was also noted that legislation in many jurisdictions refer to the “company” or an “officer” of the company and that it would be for the regulator to determine who and how many individuals to prosecute. Thus, from an enforcement perspective, it was argued that it would be pointless to nominate specific individuals to bear responsibility. In addition, it would be difficult to identify specific individuals because of the variation in how the Code is adopted and applied around the world.

IESBA members also commented specifically on the way in which the matter of responsibility had been addressed in the illustrative examples of restructured sections of the Code:

- The downside to changing to “active” from “passive” is that this could trigger significant debate about each change. Also, some provisions lend themselves to the active voice whereas others to the passive voice.
- Assigning responsibility in the Code may not reflect how firms delegate responsibility in practice. Doing so also forces the Code to make a choice and removes the ability of firms to make the appropriate judgment in the circumstances.
- While assigning responsibility could in principle make the Code more enforceable, this could also make the Code more rules-based and therefore ultimately less enforceable as it may not address all possible circumstances.

After further deliberation, the IESBA agreed to defer a final decision on whether to address the matter of responsibility as part of the Structure initiative or as a separate project until it has considered the WG’s final recommendations at the April 2014 IESBA meeting.

#### CLARITY OF LANGUAGE

IESBA members broadly supported the WG’s proposals to increase the clarity of language in the Code by, among other things:

- Reducing the reading grade of the Code
- Developing and using drafting conventions
- Avoiding stock phrases and linguistic nuances
- Using more sub-headings

- Using an editor
- Considering the translatability of exposure drafts during drafting

Mr. Thomson explained that the WG's suggestion of a reading level of Grade 15 was established by using the Flesch-Kincaid tool in Word on a random selection of paragraphs in the Code. The WG's informal assessment was that text that achieved a reading grade of 15 or lower appeared more readable whereas text above that level appeared more complex. He emphasized that this was only an informal guideline and not a formal rule. IESBA members suggested that the proposed drafting conventions could already be used on current projects.

The IESBA asked the WG to present its final proposals in this area at the April 2014 IESBA meeting.

#### ELECTRONIC CODE

The WG proposed and the IESBA tentatively supported:

- Exploring immediate enhancements in terms of electronic features if achievable with limited resources;
- Coordinating more extensive electronic features with other changes to the Code's structure; and
- Maintaining the printed version of the Code as the official version for the foreseeable future.

Mr. Holmquist noted that during the November 2013 IFAC Council workshop addressing IESBA developments, there was strong support for the concept of an e-Code. Other IESBA members commented as follows:

- There may be merit in consulting with relevant IFAC personnel to determine whether to take a coordinated IFAC approach to the introduction of enhanced electronic features to pronouncements published on the IFAC website.
- Consideration should be given to the extent to which and how electronic features and formatting would be reflected in the printed version of the Code.
- Consideration should be given to introducing electronic features in stages to minimize the strain on resources.

#### REPACKAGING

The WG proposed and the IESBA tentatively supported:

- Repackaging in conjunction with an electronic Code;
- Moving independence into a separate area within the Code provided it is clearly a subset, and linked to the rest, of the Code; and
- Considering whether to rename the Code and/or the independence standards to raise their profile and enhance the brand.

IESBA members commented as follows:

- Although some stakeholders are only interested in certain segments of the Code, IFAC member bodies' obligations under IFAC's Statement of Membership Obligations (SMO) 4<sup>4</sup> are with respect to the Code in its entirety.
- The connection between independence and ethics should not be lost in any restructuring.
- Consideration should be given to reducing repetition in the independence sections of the Code.
- Consideration should be given to moving Part C, as applicable to all members, ahead of Part B (which is only applicable to professional accountants in public practice).
- Presentation of independence standards at the end of the Code may warrant consideration.

#### COMPLEMENTARY MATERIAL

The WG proposed and the IESBA tentatively supported:

- Addressing the matter of complementary material after restructuring the Code as the restructuring may eliminate the need for some material; and
- Considering working with others to develop material or taking advantage of existing material already developed by others.

An IESBA member commented that while complementary material may be beneficial, there is a risk that it takes on a level of authority on its own. In this regard, Mr. Sylph noted that he has been charged with reviewing the terms of reference of the standard-setting boards supported by IFAC and, in particular, whether the boards' mandate is to develop authoritative pronouncements or non-authoritative material. It was suggested that staff monitor the developments within IFAC in this regard.

Mr. Kottvedgaard noted that the International Accounting Education Standards Board (IAESB) is planning to develop guidance regarding the application of the Code. Accordingly, he suggested that consideration be given to liaison with the IAESB.

#### ILLUSTRATIVE EXAMPLES

IESBA members tentatively supported the general approach taken in the illustrative examples of certain restructured sections of the Code, subject to the comments noted above. In particular, there was some support for the proposed flow of each section, i.e., comply with the conceptual framework; set out specific threats and safeguards; and set out those areas where the threat is so great that a prohibition would be appropriate. There was also support for a short statement of purpose at the beginning of each section.

Among other matters, IESBA members commented as follows:

- The current style of the Code is quasi-legal, which is not helpful; in contrast, the examples seem to be a helpful improvement in terms of clarity.
- The explicit assignment of responsibility to the firm where this was not previously clear does not appear to have made any significant difference in terms of making the Code more enforceable.

---

<sup>4</sup> SMO 4, *IESBA Code of Ethics for Professional Accountants*

However, in other places the suggested changes may have potentially altered the intended meaning of the Code.

- The board discussion about instances of potentially altered meaning in the illustrative examples as a result of assigning responsibility highlights the need to better understand the nature of the regulatory concerns regarding enforceability. In this regard, Mr. Holmquist noted that this question could be raised with the European Audit Inspection Group, which has suggested that it could explore setting up a working group to discuss the Code's enforceability with the IESBA.
- Care should be taken in focusing only on the independence section as it was revised only four years ago.

In considering whether to develop further examples, the Board noted that the larger firms integrate the Code into their policies and procedures and it is necessary that they find the independence section workable and support it. Expressing support for the direction of the proposals, an IESBA member from a large firm thought that integration into firm policies and procedures should not be a problem if the changes do not alter the meaning. However, it was noted that significant changes had been made to the examples and checking every sentence in Section 290 for changes in meaning would represent a significant amount of work.

Mr. Kjørtvedgaard suggested that the Board agree on the drafting conventions at the April 2014 IESBA meeting so that these could be applied to projects currently in progress or new projects.

#### WAY FORWARD

The IESBA asked the WG to:

- Refine the WG's preliminary recommendations and the illustrative examples to reflect the input received and develop additional examples. Additional examples should include segments of Part A and Part B (other than those sections currently being revised by other task forces), in addition to independence, but not Part C.
- Consider meeting with Board members from the larger firms to obtain further input from them regarding the implementation of a restructured independence section within their policies and procedures.
- Meet with other selected stakeholders to discuss the recommendations and examples.
- Present at the April 2014 IESBA meeting the WG's final report, including proposals for the way forward, and a project proposal addressing the restructuring of the Code.