Basis for Conclusions: 
Code of Ethics for Professional 
Accountants

Prepared by the Staff of the International Ethics 
Standards Board for Accountants

July 2009
BASIS FOR CONCLUSIONS
CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

This Basis for Conclusions has been prepared by staff of the International Ethics Standards Board for Accountants (“IESBA”). It relates to, but does not form part of, the Code of Ethics for Professional Accountants (“the Code”), which was revised by the IESBA and approved in April 2009.

Background

1. Following the issuance of exposure drafts in December 2006 and July 2007 proposing revisions to the independence provisions of Sections 290 and 291 of the Code (see www.ifac.org for the Bases of Conclusions for those projects), in July 2008, the IESBA issued an exposure draft proposing revisions to improve the drafting conventions of the Code (the drafting conventions project). The exposure draft requested comments only on the proposed changes to the Code that were the result of the drafting conventions project. The IESBA received a number of comments on the exposure draft that were outside of the scope of the drafting conventions project. The IESBA did not consider these comments as part of this project. It will consider those comments, as appropriate, in future projects.

2. Comments on the exposure draft were due on October 15, 2008. The IESBA received 47 comment letters from a variety of respondents, including regulators, IFAC member bodies, and firms. As a result of these comments, the IESBA made a number of changes and clarifications to its proposals.

Wording to Indicate Requirements

3. The exposure draft proposed that requirements in the Code be identified by the use of the word “shall.” The IESBA was of the view that this would clarify the requirements and bring the language in the Code closer to that adopted by the International Auditing and Assurance Standards Board (IAASB) as part of its clarity project.

4. A majority of respondents supported the proposal. Some respondents, while expressing support for the approach, pointed out that there were still some instances in the Code where a requirement was not identified by the use of the word “shall.” For example, the respondents noted that in some instances the Code stated that an accountant “is required” to perform a certain action as opposed to stating that the accountant “shall” perform the action. The respondents recommended that “shall” be used consistently throughout the Code. The IESBA agreed and made some revisions so that all requirements are identified in the revised Code by the use of the word “shall.”

5. Some respondents expressed concern that this proposed change gave the impression that the Code is moving further away from a principles-based Code and closer to a rules-based Code. The IESBA understands this potential perception but notes that the existing Code is a combination of principles and rules that were developed to assist professional accountants in meeting the objectives of the principles. The IESBA is of the view that the
change to “shall” more clearly identifies what were intended to be requirements in the Code to begin with. The IESBA recognizes that the explanation of the term “shall” (the term “imposes a requirement on the professional accountant or firm to comply with the specific provision in which ‘shall’ has been used”) clarifies the absolute restrictions or prohibitions in the Code, resulting in a Code that is more robust and capable of more consistent application. Furthermore, the IESBA believes that there is no conflict between a principles-based approach and absolute restrictions or prohibitions that derive from application of the principles.

Structure of the Code

6. The IESBA considered the outcome of the IAASB’s clarity project in determining proposed drafting convention changes to the Code. Under the IAASB’s clarity project, each International Standard on Auditing (ISA) states the objective to be achieved in relation to the subject matter of the ISA. In addition, each ISA specifies the requirements designed to achieve the stated objective and contains separate application material that provides further explanation and guidance to promote proper application of the standards. The IESBA considered the feasibility of applying this approach to the Code. The IESBA was of the view that because the structure of the Code is very different from the structure of the ISAs, presenting the objective to be achieved, the requirements designed to achieve that objective, and the application material, as in the ISAs, would not improve the clarity of the Code.

7. A majority of respondents supported retaining the existing structure. Those respondents noted that, while the structure adopted by the IAASB suits standards that deal with procedures, such a structure would not suit a principles-based Code that addresses, primarily, professional behavior. In addition, the respondents noted that such an approach would likely lengthen the Code and could make it more difficult to apply. A minority of respondents disagreed, being of the view that a revised structure would make the requirements clearer and would make the Code more readable and facilitate convergence. The IESBA considered the comments and was not persuaded that the suggested alternative approach would result in a Code that was clearer in all cases. In addition, the IESBA was of the view that certain aspects of the proposed change in structure could be seen as weakening the Code.

Exception Clause

8. The exposure draft contained a proposed “exception” clause that provided that in exceptional and unforeseen circumstances that were outside the control of the professional accountant, the firm or employing organization, and the client, the professional accountant may judge it necessary to depart temporarily from a specific requirement in the Code. The exposure draft provided that such a departure would be acceptable only if several specified conditions were met, including the professional accountant discussing the matter with those charged with governance and documenting the results of that discussion, disclosing the reasons for the departure to the users of the
output of the accountant’s professional services, and complying with the requirements of the Code at the earliest date that compliance can be achieved.

9. A majority of respondents supported the inclusion of the provision permitting an exception, noting that there could be circumstances where compliance with a requirement would not serve the public interest. It was also noted that it was not possible to anticipate all circumstances that could be faced by professional accountants. A significant minority disagreed with the inclusion of the exception clause, expressing the view that it would weaken the Code and undermine its requirements. Some respondents also expressed the view that an exception clause might be abused.

10. Many of the respondents who supported the inclusion of the provision commented on the conditions to be met if a departure was to be acceptable. The comments included:

- It was not necessary for the circumstances to be unforeseen.
- The requirement that the circumstances be outside of the control of all relevant parties would effectively limit the use of the paragraph to only catastrophic events.
- Requiring disclosure to the users of the output of the professional services would not necessarily be in the public interest and, in the case of an audit engagement, would undermine the credibility of the audit report.
- The provision seemed to relate to independence matters as opposed to the entire Code and, as such, it should be moved to the sections addressing independence.
- If the applicable regulator or member body has an established process for accountants to discuss conclusions reached, a discussion with them should be mandatory.

11. In the exposure draft, the IESBA asked that respondents who believed the Code should not contain a provision that permits an exception explain how the types of exceptional and unforeseen circumstances covered by the provision would be dealt with. Responses included:

- The relevant regulatory authority should apply judgment and address exceptional situations based on the facts and circumstances surrounding the situation;
- There is adequate guidance in Part A of the Code (paragraphs 100.1-100.10 and paragraphs 100.12 to 100.23 of the ED), making the proposed exception clause unnecessary;
- There should be a transition period for problematic situations involving non-audit services for new clients or for entities acquired by existing audit clients.

12. The IESBA also asked respondents whether there were other circumstances where a departure from a requirement would be acceptable. The majority of respondents that answered this question indicated that the Code should address audit client mergers and acquisitions.

13. In evaluating the exposure draft comments and redeliberating this matter, the IESBA considered three categories of exceptions:
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- Catastrophic events, such as natural disaster;
- Mergers and acquisitions; and
- Other situations.

14. *Catastrophic events* – The IESBA noted that the Code was not written for such circumstances, and it considered actions that regulators and member bodies had taken in the past when there had been a catastrophic event – for example, when books and records of numerous companies had been destroyed as a result of a terrorist act, the relevant regulator and member body allowed audit firms to assist their audit clients in recreating the destroyed data. In doing so, the audit firms provided services that are normally prohibited, but they were permitted to do so because the services were necessary to enable their clients to prepare their financial statements under an extraordinary circumstance, and it was in the public interest for the audit firms to assist in that effort. The IESBA believes that if similar catastrophic events were to occur in the future, regulators and member bodies would again take appropriate action to enable firms to provide needed services that are in the public interest, and the IESBA believes that result would be reasonable under such circumstance. For these reasons, the IESBA concluded that the Code should not contain an exception clause for these situations.

15. *Mergers and acquisitions* – The IESBA recognized that a client merger or acquisition can create independence issues for the firm because such transactions are outside the control of the firm and often thrust upon the firm the unexpected need to be independent of one or more related entities of the audit client, sometimes within a very short period of time. Accordingly, the IESBA agreed with the substantial number of respondents that indicated the Code should address such matters.

16. *Other situations* – With respect to the need for an exception clause for other situations (other than catastrophic events and acquisitions and mergers), the IESBA was of the view that the examples cited in support of such a clause were not compelling and thus it was unclear how a general exception clause would be used. The IESBA was also concerned that such an exception clause could be subject to wide interpretation and potential abuse. For these reasons, the IESBA concluded that the Code should not contain an exception clause for these other situations.

17. While the IESBA was of the view that the Code should not contain an exception clause for catastrophic events or other situations in which application of a provision of the Code would result in a disproportionate outcome or an outcome that may not be in the public interest, the IESBA recognized that, in such situations, it would often be useful for the professional accountant to discuss the matter with a member body or with the relevant regulator. Therefore, the revised Code, in paragraph 100.11, contains a provision to enable that discussion. That provision recommends that the professional accountant consult the member body or relevant regulator upon encountering an unusual circumstance in which the application of a specific requirement of the Code would result in a disproportionate outcome or an outcome that may not be in the public interest. The IESBA believes that this enabling provision can be helpful to member bodies and regulators who, without such a provision, may be unwilling to engage in a discussion with the professional accountant in
such circumstances because it would involve discussing the application of another body’s Code, rather than the member body’s or regulator’s code or rules.

Mergers and Acquisitions

18. The Code requires the firm and network firms to be independent of the audit client. In the case of an audit client that is a listed entity, independence from all of the audit client’s related entities is required. In the case of an audit client that is not a listed entity, independence is required from related entities over which the client has direct or indirect control. The IESBA considered the process of identifying and becoming independent of a new related entity. When the firm becomes aware that the audit client is involved with a merger or acquisition, the firm needs to:

- Identify the entities that will become related entities of the audit client;
- Identify any interests or relationships the firm or a network firm has with the new related entities that create independence issues; and
- Terminate the interests or relationships that are not permitted under the Code and, when the interest or relationship is permitted with safeguards, apply safeguards to eliminate the threats or reduce them to an acceptable level.

19. The types of interests and relationships that can require attention as a result of a client merger or acquisition can include any of the interests and relationships covered by the Code. The revised Code, therefore, states that when, as a result of a merger or acquisition, an entity becomes a related entity of an audit client, the firm shall identify and evaluate previous and current interests and relationships with the related entity that, taking into account available safeguards, could affect its independence and therefore its ability to continue the audit engagement after the effective date of the merger or acquisition. The IESBA believes that it is necessary for the firm to identify both current and previous interests and relationships that could affect its independence, because a previous service provided to the new related entity could create a threat to the firm’s independence.

20. The revised Code requires that after the firm identifies the interests or relationships, it take steps necessary to terminate, by the effective date of the merger or acquisition, any current interests or relationships that are not permitted under the Code. Based on feedback received from professional accountants in public practice who assist their firms in complying with the independence requirements of the Code, the IESBA understands that many of the interests and relationships can be safeguarded or terminated without much difficulty. For example, financial interests in the related entity are generally disposable if a ready market exists for the entity’s shares.

21. The IESBA recognized, however, that terminating some interests or relationships before the related entity has been able to make alternative arrangements may have broader implications for the entity and those who benefit from the interest or relationship. For example, if a firm is providing a payroll service to the related entity that includes the calculation and remittance of payroll taxes to the government, terminating that service before the entity has engaged a new payroll service provider could adversely affect the
timing of the entity’s remittances of payroll taxes and, thus, the timing of receipt of tax revenues by the government. Similarly, if a firm is providing software support to customers of the related entity, terminating that relationship before the entity has engaged a new support provider could adversely affect thousands of third-party users of the software. Therefore, if such a current interest or relationship cannot reasonably be terminated by the effective date of the merger or acquisition, the firm shall evaluate the threat that is created by such interest or relationship. By using the phrase “cannot reasonably be terminated,” the IESBA contemplates that all reasonable efforts will be made by the firm and the client to terminate the interest or relationship by the effective date of the merger or acquisition. Although judgment would apply in determining whether an interest or relationship can reasonably be terminated, a termination that is delayed merely because it would be inconvenient for the client or the firm to terminate the interest or relationship would not be an interest or relationship that “cannot reasonably be terminated.”

22. The revised Code requires the firm to discuss with those charged with governance the reasons why the interest or relationship cannot reasonably be terminated by the effective date of the merger or acquisition and the evaluation of the significance of the threat that is created by the interest or relationship. If those charged with governance request the firm to continue as its auditor the revised Code indicates the firm shall do so only if:

- the interest or relationship will be terminated as soon as reasonably possible and in all cases within six months of the effective date of the merger or acquisition;
- any individual who has such an interest or relationship, including one that has arisen through performing a non-assurance service that would not be permitted under this section, will not be a member of the engagement team for the audit or the individual responsible for the engagement quality control review (clean engagement team); and
- appropriate transitional measures will be applied, as necessary, and discussed with those charged with governance.

23. The IESBA considers six months to be a reasonable period of time that will allow most interests and relationships to be terminated if it is not reasonable to terminate them before the effective date of the merger or acquisition. When combining this limited period of time with the application of appropriate transitional measures during that period, the IESBA believes a balance is achieved between (a) the need for the firm to comply with the independence requirements of the Code as soon as possible and the importance of doing so to protect the public interest, and (b) the benefits of avoiding needless market disruption, which can be caused by a forced and unplanned change of auditors at the effective date of the acquisition.

24. The IESBA is of the view that the members of the engagement team and the individual responsible for the engagement quality control review should be free of any interests or relationships that could affect their independence and objectivity during the conduct of the audit engagement.
25. The IESBA is of the view that during the period between the effective date and the termination of the interest or relationship, transitional measures should be applied as determined to be appropriate in the circumstance. The revised Code provides the following examples of transitional measures:

- Having a professional accountant review the audit or non-assurance work as appropriate.
- Having a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, perform a review that is equivalent to an engagement quality control review.
- Engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.

The IESBA recognizes that these transitional measures are described as safeguards in other parts of the Code. The IESBA concluded that the measures should not be called safeguards in these circumstances because “safeguards” are generally recommended when an interest or relationship is otherwise permissible under the Code and safeguards can be effective on an ongoing basis and thus applied year after year. That is not the case for the transitional measures described above. While the transitional measures may serve a purpose similar to that of safeguards, by eliminating threats or reducing them to an acceptable level depending on the interest or relationship, the transitional measures cannot be applied on an ongoing basis and the interest or relationship for which they may be applied will not otherwise be permissible under the Code.

26. The IESBA considered whether discussion with a regulator should be required. The IESBA noted that in some instances the accommodation may be for a very short period of time or might relate to a relatively minor matter. Further, if the firm and the client are working toward resolution of an interest or relationship as soon as possible with the understanding that the interest or relationship cannot extend beyond six months after the effective date, there is a “clean” engagement team, and transitional measures are applied as necessary under the circumstances, the IESBA concluded that it would not be necessary to require firms to discuss the matter with regulators.

27. In some cases, the firm may have completed a significant amount of work on the audit prior to the effective date of the merger or acquisition and may be able to complete the remaining audit procedures within a short period of time after the effective date. The revised Code provides for such circumstances and states that if those charged with governance request the firm to complete the audit while continuing with an interest or relationship that could affect its independence, the firm shall only do so if:

- The firm has evaluated the significance of the threat created by such interest or relationship and discussed the evaluation with those charged with governance;
- Any individual who has such an interest or relationship, including one that has arisen through performing a non-assurance service that would not be permitted
under this section, will not be a member of the engagement team for the audit or the individual responsible for the engagement quality control review;

- Appropriate transitional measures will be applied, as necessary, and discussed with those charged with governance; and

- The firm ceases to be the auditor of the entity no later than the issuance of the audit report.

The IESBA believes that such an approach is an appropriate solution to the situation in which the firm is going to resign as auditor shortly after the effective date of the merger or acquisition, once it issues its audit report.

28. The revised Code also provides that when addressing previous and current interests and relationships with the new related entity that could affect independence, the firm shall determine whether, even if all the requirements could be met, the interests and relationships create threats that would remain so significant that its objectivity would be compromised and, if so, the firm shall cease to be the auditor of the entity. The IESBA is of the view that the threats created by some interests or relationships might be so significant that it is not possible for the firm to continue as auditor of the entity after the effective date of the merger or acquisition, despite the fact that those charged with governance are comfortable with the firm’s analysis and conclusions, the firm’s use of a clean engagement team, and the application of any transitional measures. The IESBA, therefore, concluded that the firm should make this determination even if all of the requirements set out in the mergers and acquisitions provision could be met.

29. The revised Code also requires the professional accountant to document any identified interests or relationships that affect independence that will not be terminated by the effective date of the merger or acquisition and the reasons why they will not be terminated, the transitional measures applied, the results of the discussion with those charged with governance, and the rationale as to why the previous and current interests and relationships do not create threats that would remain so significant that objectivity would be compromised. Although paragraph 290.29 contains a documentation requirement that would apply in these situations, the IESBA concluded that it is important to be explicit about the documentation that is required in merger and acquisition situations given that under certain conditions the related provisions would provide a limited period of time after the effective date of the merger or acquisition for firms to become compliant with the independence requirements of the Code.

Threats

30. The Code identifies five categories of threats to compliance with the fundamental principles. The exposure draft proposed a revised description of a threat and revised descriptions of each category of threat. Respondents to the exposure draft implicitly or explicitly agreed with the proposed changes.
Clearly Insignificant

31. The exposure draft proposed eliminating the reference to “clearly insignificant” in the description of the application of the conceptual framework in favor of “acceptable level.” The exposure draft also provided a definition of an acceptable level as one “at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised.” Respondents were supportive of the proposed change agreeing that it is a more efficient and effective way of applying the threats and safeguards analysis set out in the conceptual framework and eliminates uncertainty about the interplay between the terms “clearly insignificant” and “acceptable level.”

Documentation

32. The exposure draft also proposed changes to the documentation requirements and called for documentation of identified threats that require the application of safeguards. The accountant would be required to document the nature of those threats and the safeguards applied to eliminate the threats or reduce them to an acceptable level. A majority of the respondents were supportive of the proposed change, but a minority was of the view that the documentation requirement should be strengthened. Those respondents noted that there is a large degree of judgment required when assessing whether a threat is at an acceptable level and documentation should, therefore, also capture those situations. The IESBA concluded that it was important to document those threats that were “at the margin;” that is, threats that were determined to be at an acceptable level but were close to the line and required significant analysis to reach a conclusion that safeguards would not need to be applied. The revised Code, therefore, contains the following additional requirement:

When a threat required significant analysis to determine whether safeguards were necessary and the professional accountant concluded that they were not because the threat was already at an acceptable level, the professional accountant shall document the nature of the threat and the rationale for the conclusion.

Other Changes

33. The Code previously stated that Parts B and C of the Code include “examples that are intended to illustrate how the conceptual framework is to be applied.” The use of the word “examples” led some to question whether accountants are required to follow the guidance in those examples. The exposure draft therefore proposed a change to clarify that accountants are required to follow the guidance in those examples by removing the word “examples.” The exposure draft (paragraph 100.12) stated:

Parts B and C of this Code describe how the conceptual framework is to be applied. Parts B and C do not describe all the circumstances that could be experienced by a professional accountant that create or may create threats to
34. Some respondents, however, expressed concern that the proposed change could be interpreted by some as meaning the professional accountant should only apply the conceptual framework approach in those circumstances where a specific situation is not addressed by the Code. This was not the intention of the IESBA and, therefore, the paragraph has been deleted in the revised Code.

35. The exposure draft (paragraph 140.4) stated that a “professional accountant shall be aware of the need to maintain confidentiality of information within a firm or employing organization.” Some respondents indicated that the requirement should be to maintain confidentiality as opposed to being aware of the need to maintain it. The IESBA agreed with this view and the revised Code, therefore, contains this requirement.

36. One respondent pointed out that the exposure draft did not use consistent language in discussing the possible implications of an inadvertent violation of a provision of the Code. In some cases, the exposure draft stated that a matter “is not deemed to compromise,” in another case it stated a matter “may not be deemed to compromise,” and in another case it “generally would not be deemed” to compromise. The respondent expressed the view that the treatment should be consistent and suggested that it would be clearer if “not” were attached to the verb “compromise” as opposed to the verb “deem.” The ISEBA agreed and the revised Code, when discussing inadvertent violations, now states that the matter will be “deemed not to compromise.”

37. The exposure draft (paragraph 290.33) refers to “appropriate quality control policies and procedures.” Recognizing that International Standards on Quality Control provide the benchmark for such matters, the revised Code refers to “appropriate quality control policies and procedures, equivalent to those required by International Standards on Quality Control.”

38. The exposure draft proposed changes to the Code consistent with the following principles of drafting:

- “Consider” will be used where the accountant is required to think about several matters;
- “Evaluate” will be used when the accountant has to assess and weigh the significance of a matter; and
- “Determine” will be used when the accountant has to conclude and make a decision.

The IESBA noted that these conventions are consistent with the definitions of those words found in standard dictionaries. The majority of respondents did not comment on this proposed change.

39. The IESBA made a number of editorial changes to the definitions in the Code to bring them in line with the definitions used in the ISAs.
Effective Date

40. The exposure draft proposed that the revised Code be effective on December 15, 2010, subject to certain transitional provisions, with earlier adoption encouraged. The transitional provisions addressed new requirements for partner rotation, public interest entities, and the provision of non-assurance services that were decided upon by the IESBA in its earlier project to reconsider the independence requirements of the Code.

41. Some respondents, while agreeing with the proposed effective date, expressed the view that it was ambitious and were concerned that an encouragement to early adopt would create added pressure on some firms and member bodies to accelerate their adoption of the new Code. The IESBA recognized that some firms and member bodies may need the full 18 months to effect an orderly implementation of the changes. The revised Code, therefore, contains the more neutral statement that early adoption is permitted, thus avoiding any implication that a hurried approach is desired.

42. A majority of respondents supported the proposed point in time effective date, stating that this would make the effective date provisions easier to apply and understand. A minority of respondents expressed the view that the effective date for the sections addressing independence matters should be linked to the period covered by the assurance report. These respondents were of the view that the independence provisions should be consistent throughout the period of a single assurance engagement. The IESBA considered the comments and agreed that a point in time effective date was preferable, subject to the related matters referred to below.

43. One respondent stated that because the proposed point in time effective date was so close to the calendar year end, it would be clearer, and easier, for all parties to implement if the effective date were January 1, 2011. The IESBA agreed and the revised Code, therefore, has an effective date of January 1, 2011.

44. Some respondents commented that the point in time effective date might pose unique difficulties for the revised partner rotation requirements affecting new key audit partners and public interest entity audit client. For example, when read literally a December 15, 2011 effective date (reflecting a one-year delayed effective date as proposed in the exposure draft) could have been interpreted as requiring an individual to rotate on December 14, 2011, which could be in the middle of the year-end audit engagement for an audit client with a calendar year-end. The IESBA agreed that this is not the intent and the transitional provision for partner rotation in the revised Code has therefore been linked to the client’s year-end, requiring rotation of new key audit partners for fiscal years beginning on or after December 15, 2011. This will enable the partner to complete work, for example, on the calendar year 2011 audit in 2012 prior to rotating off the audit engagement.

45. One respondent expressed the view that transitional provisions should be explicit that a “fresh start” approach is to be adopted for the requirements related to relative size of fees. The IESBA agreed, noting that without such a fresh-start, the change would be applied retrospectively. The IESBA determined that this transitional provision should also be linked to the audit client’s fiscal period. The revised Code, therefore states that these
requirements are effective for audits of financial statements for fiscal periods beginning on or after December 15, 2010. Under this approach, assuming the client had a December 31 year end, a pre- or post-issuance review would be required if the total fees from a public interest entity audit client exceed 15% of the firm’s total fees for the years 2011 and 2012 and accordingly, the review would be conducted with respect to the 2012 audit.

46. In its review of the transitional provisions, the IESBA considered whether a transitional provision was necessary for the new requirement prohibiting a key audit partner from being evaluated on or compensated based on the partner’s success in selling non-assurance services to his or her audit client. The IESBA recognized that firms may need to change their partnership agreements to comply with the new requirements. The revised Code, therefore, contains a transitional provision for these requirements under which firms will have an additional year in which to accomplish any necessary policy change so that evaluations after January 1, 2012 are in compliance with the provisions of the Code. Additionally, under the transitional provision, compensation paid after January 1, 2012, by reference to performance evaluations covering any period prior to January 1, 2012 would be permitted.

47. A majority of respondents were supportive of the transitional provisions for the new requirements relating to public interest entities and the provision of non-assurance services. The revised Code, therefore, includes the transitional provisions that were exposed for comment.