

Structure Phases 1 and 2 – Issues and Task Force Proposals**How the Project Serves the Public Interest**

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

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

How this Paper is Organized

This paper addresses the following topics:

I: Structure of the Code Phase 1

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- B. Matters Considered by the Task Force Since the Board's September 2016 meeting
 - "Insignificant" Network Firms
 - Relationships of Partners and Employees of the Firm or Network Firm
 - The Use of Materiality in the Code
 - The Use of "May" and "Might"
 - References to Immediate Family/Close Family Member

II: Structure of the Code Phase 2

- A. Background
- B. Matters Pertaining to Restructuring Section 800¹
 - Disposition of the Board's September 2016 Comments
- C. Matters Pertaining to Restructuring Part 4B²
 - Independence Requirements for Audits of Specific Elements, Accounts or Items of a Financial Statement
 - Disposition of the Board's September 2016 Comments and Other Editorials

III: Other Matters

- Consistency Review
- Electronic Enhancements
- Forward Timeline
- Matters For Board Attention

¹ Section 800, *Reports that Include a Restriction on Use and Distribution*

² Part 4B, *Independence for Other Assurance Engagements*

I. Structure of the Code Phase 1

A. Background

1. At its September 2016 meeting, the IESBA considered revised the text to address the Task Force's responses to Structure ED-1 and the input from the June 2016 Board discussions and the IESBA Consultative Advisory Group (CAG). **Agenda Item 3-B** includes the Task Force's further revisions to address the IESBA's input. The Task Force also considered the September 2016 comments from the IFAC Small and Medium Practitioner Committee (SMPC). The SMPC was supportive of the general approach and revisions to the structure of the proposed restructured Code including the deletion of many of the recurring requirements to apply the conceptual framework. The SMPC encouraged publication of an article on the IFAC *Gateway* and IESBA staff will address this issue. The proposed Structure Phase 1 text set out **Agenda Item 3-B** includes, in gray text, conforming amendments arising from the Safeguards project. Those conforming amendments will be presented during the Safeguards session of the December 2016 IESBA meeting. Accordingly, section C of **Agenda Item 4-A**, summarizes the rationale for those conforming amendments.
2. Updated drafting guidelines (see **Agenda Item 3-I**) have been provided to the other task forces working on restructuring. As noted at **Agenda 3**, The Task Force continues its close liaison with the other task forces to develop a restructured Code that reflects a consistent approach designed to achieve the objectives of the Structure project.
3. The Task Force has presented an updated staff-prepared compilation of the complete text to facilitate a review that encompasses Phase 1 and 2 of the Structure and Safeguards projects. (See **Agenda Item 3-F**).

B. Matters Considered by the Task Force Since the Board's September 2016 Meeting

"Insignificant" Network Firms

4. An IESBA member was concerned that further clarification of the application of a materiality or significance test to network firms was required. On further review the application of such tests to "insignificant" network firms has been refined clarified so as to avoid a possible unintended consequence when an insignificant network firm has a business relationship of the type addressed in Section 520³ (see paragraph 520.6 (c) of **Agenda Item 3-B**).

Relationships of Partners and Employees of the Firm or Network Firm

5. An IESBA member suggested that the meaning of extant paragraph 290.131 had been changed in paragraph R521.9 of the proposed restructured Code. Both paragraphs are set out in the table below. The IESBA member considered that this paragraph imposed a new obligation on individuals to report not only their own family relationships but also, if known, the family relationships of other members of the firm. The Task Force carefully considered the wording of the extant Code in Section 290.131 and concluded that there was no change in meaning as this requirement exists in the extant Code.

³ Proposed restructured Code, Section 520 – *Business Relationships*

<i>Family and Personal Relationships – Extract from extant Code Paragraph 290.131</i>	<i>Relationships of Partners and Employees of the Firm or Network Firm – proposed restructured Code paragraph R521.9</i>
<p>Self-interest, familiarity or intimidation threats may be created by a personal or family relationship between</p> <p>(a) A partner or employee of the firm who is not a member of the audit team and</p> <p>(b) A director or officer of the audit client or an employee in a position to exert significant influence over the preparation of the client’s accounting records or the financial statements on which the firm will express an opinion. Partners and employees of the firm who are aware of such relationships shall consult in accordance with firm policies and procedures.</p> <p>...</p>	<p>Partners and employees of the firm shall consult in accordance with firm policies and procedures if they are aware of a personal or family relationship between:</p> <p>(a) A partner or employee of the firm who is not an audit team member; and</p> <p>(b) A director or officer of the audit client or an employee of the audit client in a position to exert significant influence over the preparation of the client’s accounting records or the financial statements on which the firm will express an opinion.</p>

Glossary References to Materiality in the Code

6. At the September 2016 meeting an IESBA member questioned the Glossary’s listing of multiple individual paragraph references dealing with materiality:

Materiality* *This term is described in paragraphs 510.3 A1, 511.4 A1, 520.3 A1, 910.3 A1, 911.2 A1 and 920.1 A1 for use in the relevant context of each of those sections.*

Materiality in Relation to An Audit of Financial Statements is described in paragraph 600.3 A5 and is relevant for Sections 600 to 699.

The IESBA member also commented that there were other references to materiality in the Code that were not defined which made the issue of materiality appear to be somewhat confusing.

7. The Structure Task Force was aware of the issue concerning materiality as it had already raised it as a matter for future Board attention (see paragraph 13 of [Agenda Item 3-I](#) to the September 2016 IESBA meeting as follows:

Materiality

Materiality is a concept that is applicable across the Code, both relating to non-assurance services (NAS) and for example in the independence standards. For example, paragraph 510.3 notes that the “Section 510, Financial Interests refer to the “materiality” or “significance” of a financial interest. Section 510 states that “for the purposes of determining whether such an interest is material to an individual, the combined net worth of the individual and the individual’s immediate family members may be taken into account.” A broader consideration of how the concept of materiality should apply in the context of the full Code, and not just NAS, might be needed and would require coordination with the IAASB and the International Accounting Standards Board.

8. The Structure Task Force considered the input received and continues to believe that the issue is a matter for Board attention, and further consideration about whether it might be considered in another project. The Task Force has also dropped the reference to materiality in the Glossary so as not to emphasize its different applications pending the Board's full review. The Task Force believe that this approach will remove potential confusion that might have been introduced. (See paragraphs 10 and 11 of the Guide to the Code and the alphabetic insertions in the Glossary.)

The Use of "May" and "Might"

9. The Structure Task Force exposed Structure ED-1 using a drafting guideline based on limiting the use of "may" to denote permission and the use of "might" to refer to possible matters, events or actions. Respondents to ED 1 did not raise issues or concerns regarding the use of "may" and "might." A respondent⁴ queried whether using "might" instead of "may" implied a weaker interpretation of a few of the extant Code's provisions which were further reviewed by the Task Force. However, the concern was not related to the principles explained in the drafting guidelines.
10. Following the discussion at the September 2016 IESBA CAG's meeting the Structure Task Force has reviewed its approach to the use of "might" and "may." Because these terms have a particular meaning in the Code, the Task Force has included a reference to 'may' and 'might' in the *Guide to the Code* and the Glossary. The definition in the Glossary is slightly revised from the previously circulated Drafting Guidelines as it now includes a reference to exceptions. (See paragraphs 10 to 11 in the Guide to the Code and the alphabetic insertions in the Glossary.)

References to Immediate Family/Close Family Member

11. A member of the Board was concerned about the use of the word "member" following "close family" and "immediate family," believing its use to be inconsistent. The IESBA member was concerned that sometimes the defined term was followed by "member" and on other occasions it was not. The Task Force has examined the matter raised and believes that in context it uses the word "member" consistently. The Task Force acknowledges that in some cases "immediate family" is used on its own and in other cases it is followed by "member" and believes its use is appropriate in the relevant context. Respondents to Structure ED-1 did not comment on this issue. The Task Force is of the view that no change is necessary.

Matter for IESBA Consideration

1. Do IESBA members have any specific comments or suggestions regarding the revised text of Structure Phase 1 presented by the Task Force set out in **Agenda Item 3-B**?

⁴ National Standard Setter – APESB

II. Structure of the Code Phase 2

A. Background

12. At its September 2016 meeting, the Board considered a third draft of proposed Section 800, and further drafts of certain sections within proposed Part 4B.⁵ The Task Force has reflected on the Board's input and has developed further revisions in line with the restructuring approach.
13. **Agenda Item 3-D** includes the Task Force's revised proposals. A disposition of the Board's feedback is included in paragraphs 15-16 below for Section 800 and paragraph 19 below for Part 4B.
14. The proposals in Sections 800 and Part 4B reflect the drafting guidelines for restructuring the Code set out in **Agenda Item 3-I**. The Task Force's proposals for Structure Phase 2 also include, when appropriate, conforming amendments arising from Phase 1 of the Safeguards project. Those conforming amendments are shown in gray text in **Agenda Item 3-D** and will be presented during the Safeguards Task Force.

B. Matters Pertaining to Restructuring Section 800

Disposition of IESBA September 2016 Comments

15. The Board discussed and agreed to a few editorial refinements to Section 800 during its September 2016 meeting.
16. Following the September 2016 Board Meeting the Task Force further refined its proposals based on its consistency review. The Task Force also reordered the introductory text in Section 800 to conform to the proposed restructured Code's drafting conventions.

Matter for IESBA Consideration

2. Do IESBA members have any specific comments or suggestions regarding the Section 800 text presented by the Task Force?

C. Matters Pertaining to Restructuring Part 4B

17. **Agenda Item 3-D** includes the Task Force's proposals for restructuring certain paragraphs within Section 291 of the extant Code, including *Long Association of Senior Personnel with an Assurance Client*;⁶ *Non-assurance Services to an Assurance Client*⁷ and *Reports that Include a Restriction on Use and Distribution*.⁸

⁵ The following sections within Part 4B were presented to IESBA at its September 2016 meeting: Section 900, *Applying the Conceptual Framework to Independence for Other Assurance Engagements*; Section 905, *Fees*; Section 906, *Gifts and Hospitality*; Sections 910, *Financial Interests*; Section 911, *Loans and Guarantees*; Section 920, *Business Relationships*; Section 921, *Family and Personal Relationships*; Section 922, *Recent Service with an Assurance Client*; Section 923, *Serving as a Director or Officer of An Assurance Client*; Section 924, *Employment with an Assurance Client*; and Section 999, *Reports that Include a Restriction on Use and Distribution*. Section 950, *Provision of Non-assurance Services to An Assurance Client* is set out in **Agenda Item 4-E**.

⁶ Extant Part B, *Long Association of Senior Personnel with an Assurance Client*, paragraphs 291.137. See proposed restructured Long Association proposals at **Agenda Item 8-B**.

⁷ Extant Part B, *Provision of Non-assurance Services to an Assurance Client*, paragraphs 291.138–291.148

⁸ Extant Part B, *Reports that Include a Restriction on Use and Distribution*

18. At the September 2016 Board meeting it was agreed that the independence requirements and application material set out in Part 4-B are applicable for audits of specific elements, accounts or items of a financial statement. A sentence expressing this point was included in paragraph 900.1 of the proposed restructured Code. The Board commented that this additional sentence might focus too much attention on one form of assurance engagement. Accordingly, the example in paragraph 900.1 was adjusted to include reference to another type of assurance engagement, “an audit of internal controls over financial reporting.”

Disposition of the Board's September 2016 Comments and Other Editorials

19. Following the discussion at the September 2016 Board meeting the Task Force made minor adjustments to the text of Part 4B including:
- (a) Adjusting the order of the introductory paragraphs so that they conform with the revised drafting guidelines.
 - (b) Introducing immediately before paragraphs 900.15, 910.4 A1, 911.4 A1, 920.4 A1, 921.4 A1, R922.4, R923.4, 924.4 A1 of the proposed restructured Code the heading “General” so as to differentiate the material that followed from specific subject matter material.
 - (c) Making conforming amendments from Part 4-A.
 - (d) Reinstating the reference to “directly” and “indirectly” (made in paragraph 510.4 A1 of Structure ED-1 in paragraph 910.4 A1 of the proposed restructured Code).

Consistency Review

20. Staff has conducted a consistency review in consultation with the Task Force and other task forces and respective staff. The results of this review is reflected in the agenda meeting materials, including the Staff-prepared Compilation document at **Agenda Item 3-F**.

Matter for Consideration

- 3. Do IESBA Members have any specific comments or suggestions regarding the text of Sections 900 to 999 presented by the Task Force?
- 4. Do IESBA Members have any comments or suggestions on consistent achievement of the key features of the restructuring throughout the restructured Code, with reference as appropriate to the compilation document? (See **Agenda Item 3-F**)

III. Other Matters

Electronic Enhancements

21. It is anticipated that following issuance of Structure ED-2 in January 2017 further work will be undertaken future electronic enhancements to the electronic Code.

Forward Timeline

22. The Task Force is seeking to obtain the Board’s agreement in principle for Phase 1 at this meeting and approval of Structure ED-2 for issuance in 2017. This will include Phases 1 and 2 of the Structure of the Code and the Safeguards projects and proposals relating to applicability of the PAIB section of the restructured Code. Structure ED-2 will include a hyperlink to a Staff-prepared Compilation of

the Restructured Code, except for Section 350.⁹ **Agenda Item 3-F** is a draft of this compilation document.

23. To assist the Board the Task Force has prepared a draft Basis-for-Agreement in Principle regarding Phase 1 of the Structure project which is included at **Agenda Item 3-G**. It has also prepared a draft Explanatory Memorandum (EM) that might complement Structure ED-2. Subject to agreement-in-principle of the Structure Phase 1 text, and approval of the proposed text for Structure ED-2, the Task Force proposes that the Board discuss the draft Basis for Agreement in Principle, and draft EM at the meeting.
24. An updated version of the December 2015 IESBA Update, [*Restructuring the Code of Ethics for Professional Accountants*](#) is intended to be released with Structure ED-2. A draft of this document is included at **Agenda Item 3-E**. It includes a forward timeline illustrating the timing of the Structure related work-streams.

Matters for Board Attention

25. Since the September 2016 meeting, the Task Force has identified the following two matters relating to definitions for Board attention arising from the Structure Project.
 - (a) The proposed restructured Code uses the term “personnel” instead of “staff.” This change was to ensure a more universal reference to individuals across the Code. To be consistent throughout the Code this change would be required to the definitions “engagement team” and “external expert” which are aligned with wording in the International Standards on Auditing.
 - (b) The proposed restructured Code uses the term “individual.” To be consistent this would need to be reflected in the definition of “Those Charged with Governance.” Both these definitional issues would require liaison with the International Auditing and Assurance Standards Board.

Matter for IESBA Consideration

5. IESBA members are asked for views on next steps, and any other matters pertaining to the Structure of the Code project.

⁹ Extant Section 350, *Inducements* (restructured Section 250). The revision of extant Section 350 forms part of Part C Phase 2. See Agenda Item 5. Planned approval for the Part C Phase 2 ED is March 2017.