

Basis for Agreement-in-Principle [January 2017]

Note to Meeting Participants

This document will be updated to incorporate the Board's final conclusions as agreed during its December 2016 meeting.

*International Ethics Standards Board for
Accountants®*

[Draft] Basis for Agreement- in-Principle for *Improving the Structure of the Code of Ethics for Professional Accountants—Phase 1*



This document was prepared by the Staff of the International Ethics Standards Board for Accountants® (IESBA®).

The IESBA is an independent standard-setting board that develops and issues high-quality ethical standards and other pronouncements for professional accountants worldwide. Through its activities, the IESBA develops the *Code of Ethics for Professional Accountants*, which establishes ethical requirements for professional accountants.

The objective of the IESBA is to serve the public interest by setting high-quality ethical standards for professional accountants and by facilitating the convergence of international and national ethical standards, including auditor independence requirements, through the development of a robust, internationally appropriate code of ethics.

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BASIS FOR AGREEMENT-IN-PRINCIPLE

I. Introduction

1. It is in the public interest for the *Code of Ethics for Professional Accountants* (the Code) to be understandable and usable. In restructuring the Code, the IESBA is aiming to enhance the understandability and usability of the Code, thereby facilitating its adoption, effective implementation, consistent application, and enforcement.
2. The IESBA agreed in principle to the text of Phase 1 of its Structure of the Code project (Structure project) in December 2016. This Basis for Agreement-in-Principle explains the rationale for the Board's revisions to its proposals that were exposed as part of the December 2015 Exposure Draft [*Improving the Structure of the Code of Ethics for Professional Accountants – Phase 1*](#) (Structure ED-1).

II. Background

3. In December 2015, the IESBA published its proposals in Structure ED-1. Fifty comment letters were received from various respondents, including regulators and audit oversight authorities, national standard setters, firms, public sector organizations, preparers, IFAC member bodies, other professional organizations and individuals.
4. There was widespread support for the key features of the restructuring. Some respondents indicated that in their view the improved understandability of the proposed restructured Code will facilitate compliance and enforcement. Responses to questions about Small and Medium Practices (SMPs), developing nations, translation and adoption reflected similar views.
5. While expressing support for Structure ED-1, a number of respondents requested the opportunity to have the complete proposed restructured Code available for reference, in order to comment on the proposals relating to Phase 2 of the Structure of the Code project. Responsive to this request, a Staff-prepared compilation of the text for the proposed restructured Code is available at [the IESBA's website] to assist readers to understand how the various restructuring work streams fit together. To facilitate respondents in tracking the restructuring changes of the material in the extant Code to the proposed restructured text:
 - A Staff-prepared Mapping Table, and for recently changed sections of the extant Code,¹ marked from extant drafts of the restructured material is also available at the [IESBA's website].
 - The agreed-in-principle text for Phase 1 and the proposed text for Phase 2 of the Structure project include a comment to explain its derivation, i.e., whether it is from a particular paragraph in the extant Code, or whether it is a new requirement or application material. These comments are also included in the Staff-prepared compilation of the restructured Code.
6. Throughout this document, reference is made to the agree-in-principle text for Phase 1 of the Structure project and the Board's initial proposals set out in Structure ED-1. The first numeric reference to text relates to Structure ED-1 and the second to the Staff-prepared compilation of the proposed restructured Code. [\[Insert hyperlink\]](#)

¹ Recently changed sections of the Code relate to Part C Phase 1, Long Association and Non-compliance with Law and Regulation. Staff-prepared marked from extant versions of the restructured text are available at the IESBA's website.

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7. During the restructuring work, the IESBA identified a number of matters that would involve potential changes outside the scope of the project. The IESBA is considering these matters for [further consideration](#) as it develops its next strategy and work plan.

III. Basis for Agreement-in-Principle

Key Elements of the Restructuring

8. Key elements of the restructuring include:
- (a) Increased prominence of the requirement to apply the conceptual framework and comply with the fundamental principles.
 - (b) Requirements separately identified – in separate paragraphs identified with an ‘R’.
 - (c) Application material generally positioned next to the relevant requirements – paragraphs identified with ‘A’.
 - (d) Increased clarity of responsibility – more clearly enabling identification, where relevant, of a firm’s responsibilities and, together with firms’ policies and procedures, the responsibilities of particular professional accountants.
 - (e) Increased clarity of language – where possible: simpler and shorter sentences; simplifying complex grammatical structures; increased use of the active voice; avoiding legalistic and archaic terms.
 - (f) Specific references to network firms to clarify when the Code applies to them.
9. Additional aspects of the restructuring are as follows:
- (a) The addition of a *Guide to the Code*.
 - (b) Reorganizing the Code as appropriate, to enhance clarity and usability, positioning the Code to take advantage of forthcoming electronic features.
 - (c) Organization of the material into more self-contained sections and subsections so that:
 - o Each Section has its own introduction to provide an overview and context, including the threats that might exist, and references the fundamental principles.
 - o Revised numbering to facilitate revisions.
 - (d) Reversal of extant Parts B² and C³ to recognize the relevance of professional accountants in business material to professional accountants in practice in certain circumstances. This also facilitates presentation of the independence sections of the Code after other material.
 - (e) Independence sections moved to the end of the Code, re-titled as the *International Independence Standards (IIS)*.⁴

² Extant Code Part B – *Professional Accountants in Public Practice*

³ Extant Code Part C – *Professional Accountants in Business*

⁴ Proposed Restructured Code the *International Independence Standards Part 4A Independence for Audits and Reviews*, (Sections 400 to 899) and Part 4B *Independence for Other Assurance Engagements*, (Sections 900 to 999)

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- (f) Definitions section enhanced and presented as a glossary, which also includes descriptions of terms used.
 - (g) A new title for the Code.
10. The matters that are discussed below are refinements to the text of Structure ED-1.

The Conceptual Framework, the Fundamental Principles and the IIS

11. Structure ED-1 promoted the importance of applying the conceptual framework and proposed clarifying its importance by including a requirement to apply the conceptual framework at the beginning of each section. To remind professional accountants of this requirement, a sentence was included in the header to each page in Structure ED-1. While there was widespread support from respondents for these proposals, some respondents made specific drafting suggestions including that:
- The overarching requirement to comply with the fundamental principles be given even greater prominence.
 - With appropriate positioning of requirements, that unnecessary repetition be avoided – for example, the banner heading reminder to apply the conceptual framework would no longer be necessary.
 - The overarching requirement to be independent when subject to the IIS be given greater prominence.
 - The description of the connection between independence and the fundamental principles be enhanced.
 - The application of the conceptual framework to the IIS be clarified.
 - The interaction between the conceptual framework and specific requirements and application material be clarified so as not to lose the focus on the fundamental principles when setting out specific requirements and application material.

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12. The IESBA agreed:
- To revise the introductory material in each section throughout the Code reminding users of the requirement to comply with the fundamental principles.
 - To retain the reminders to apply the conceptual framework with a focus to include the overall objective and not simply the process of achieving the objective.
 - To remove the banner heading.
 - To add revised introductory material in each independence section throughout the Code reminding users of the requirement to be independent.
 - To delete the statement in paragraph 400.1 that “independence is a measure of objectivity.”

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- To revise Section 120, *The Conceptual Framework*, to repeat the definition of independence from paragraph 400.2 to create a clearer linkage between the fundamental principles and independence when addressing the application of the conceptual framework.
- To revise Section 120 to establish a requirement that a professional accountant apply the conceptual framework to threats to compliance with independence standards as well as threats to compliance with the fundamental principles when performing an engagement requiring independence.
- To revise the introductory language mentioned above to clarify that: compliance with the fundamental principles; maintaining independence when required to be independent; and application of the conceptual framework; are overarching requirements which precede the compliance with available specific requirements.
- To add a cross-reference from Section 120⁵ to other areas of the Code that provide additional requirements and application material relevant to the application of the conceptual framework.

Ordering of Requirements and Application Material

13. Structure ED-1 proposed that the ordering of requirements be influenced by the overall applicability of the Code's principles-based approach highlighting all requirements, giving prominence to prohibitions and the overarching requirement to comply with the fundamental principles. This took into account comments from respondents to the November 2014 Consultation Paper, [Improving the Structure of the Code for Professional Accountants](#). Respondents to Structure ED-1 also supported and emphasized the importance of a principles-based approach and the overarching requirements to comply with the fundamental principles; and the need to apply the conceptual framework. Respondents were concerned that the Code should not be structured in a way that might imply specific requirements could be applied without consideration of these overarching requirements. Some respondents to the December 2015 ED, [Proposed Revisions Pertaining to Safeguards in the Code – Phase 1](#) (Safeguards ED-1) emphasized the importance of prominent prohibitions.

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14. In the light of the support from respondents, the IESBA agreed, consistent with the principles basis of the Code, scalability and the application of the conceptual framework, that the order of the requirements and application material within each section of the proposed restructured Code be as follows:
- The requirements and application material related to applying the conceptual framework are set out first, followed by specific requirements.
 - Recognizing the need for scalability, requirements that apply to public interest entities are located after requirements that apply to other entities.
 - Application material that is specific to a particular requirement follows the related requirement as closely as possible.

⁵ Section 120 – *The Conceptual Framework*

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Clarity of Responsibility for Compliance with the Code

15. Structure ED-1 proposed: reducing the use of the passive voice and retaining the extant Code's reference to ISQC 1⁶ to clarify responsibility in the Code in paragraph 400.7 (400.5 in Structure ED-2 [\[insert link\]](#)). It also added the sentence: "Although firms and professional accountants within those firms each have responsibilities for compliance, for ease of reference, many of the provisions of C1 (Part 4B in Structure ED-2) refer to "firm," even if the main responsibility rests with an individual within the firm." Respondents supported the reduced use of the passive voice and the continued reference to ISQC 1. Many respondents supported or accepted the proposed restructured Code's use of the word "firm" for ease of reference. Some respondents did not support the approach always to refer to "firm" in C1 (Part 4B). A few respondents expressed the view that Structure ED-1 did not use consistent terminology to clarify responsibility.

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16. The IESBA reaffirmed its view that the text of Structure ED-1 properly reflected professional accountants' responsibilities while recognizing that specific assignment of responsibilities will be impacted by firms' policies and procedures. It reaffirmed its view that, as explained in paragraph 400.7 (400.5 in Structure ED-2), it is reasonable to use the term "firm" for ease of reference. In addition, it determined, for greater clarity, to include a reference in Section 120 to the use of the term "firm."

Use of the Phrase "Generally Necessary" in the Code

17. A respondent suggested that the phrase "generally necessary" should be converted into a requirement because it is unclear in its meaning. The phrase "generally necessary" is only used in two places in the proposed restructured Code, namely in the application guidance accompanying the requirement regarding disclosure of a conflict of interest, in paragraphs 210.8A17 and 310.9 A3.8 The IESBA considered that:
- Professional guidance on conflicts of interest is a topic of considerable difficulty and variation in practice across jurisdictions and disciplines.
 - Disclosure and consent can take a number of forms which vary across jurisdictions, disciplines and service types.
 - Obtaining consent is not always a practical proposition, for example if there are multiple users of the report (particularly where a report is to be made public) and the professional will not be interacting with each and every user.
 - The need for disclosure and consent will depend on the significance of the conflict.

⁶ International Standard on Quality Control 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements*

⁷ Relating to Professional Accountants in Business

⁸ Relation to Professional Accountants in Public Practice

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- Although not a safeguard, disclosure to and consent of parties potentially affected by a conflict of interest plays a part in managing a conflict and is generally desirable if not actually required. However, disclosure might conflict with the fundamental principle of confidentiality.

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18. The IESBA concluded that it is appropriate to retain the phrase in the two instances where it is used in the draft restructured Code. The IESBA decided that it is not possible to define all the circumstances in which disclosure and consent are or are not necessary. Rather, it is a question of professional judgment. Accordingly, the Code requires the professional accountant to exercise professional judgment. This is to determine whether the nature and significance of a conflict of interest are such that specific disclosure and explicit consent are necessary when addressing the threat created by the conflict of interest and provides factors to consider in making that determination.

Suggestions to Avoid Possible Changes of Meaning and Other Drafting Suggestions

19. Structure ED-1 proposed to improve the understandability and usability of the Code by restructuring it without changing its meaning, except in limited circumstances where determined necessary by the Board. The Structure ED-1 proposals sought to avoid inadvertent changes in the meaning of the Code including inadvertent reduction in requirements or other weakening of the Code. A number of respondents to Structure ED-1 nevertheless made comments regarding possible changes of meaning. Respondents also made a number of other drafting suggestions including suggestions aimed at reducing duplication of material and further opportunities to improve the flow and readability of the text. The IESBA gave careful consideration to each of the comments and suggestions.
20. Structure ED-1 proposed that the term “network firm” be distinguished from the term “firm.” Respondents to Structure ED-1 supported this proposal. In some instances, respondents indicated that this proposal required further clarification of the application of a materiality or significance test to network firms.

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21. The IESBA determined to make revisions to the proposed restructured Code where it considered that Structure ED-1 proposals might have inadvertently changed the meaning of the Code and where respondents’ suggestions improved the readability and usability of the proposed restructured Code for example when making reference to network firms. On further review the IESBA clarified the application of materiality or significance tests to insignificant network firms so as to avoid inadvertent change in meaning or any unintended consequences.

The Guide to the Code (The Guide)

22. Structure ED-1 proposed that the Guide to the Code be included within the body of the proposed restructured Code. The IESBA considered that it was important that the Guide should be read with the proposed restructured Code itself. However, respondents commented that the Guide to the Code was a navigational aid and should not contain the Code’s application material as the Guide does not have the same authority as the Code and placement of application material in the Guide might also change its meaning.

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23. Certain application material relating to disproportionate outcomes (paragraph 10) and ethical conflict resolution (paragraphs 11-12) was located in the Guide. Respondents considered this to be important material which should be located in the body of the Code.
24. The IESBA 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. A respondent queried whether using “might” instead of “may” implied a weaker interpretation of some of the extant Code’s provisions. The drafting guidelines addressed the ambiguity that in the extant Code “may” denoted both permission and possibility.

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25. In response to comments from respondents the IESBA determined to separate the Guide from the Code. The IESBA also decided to return the material regarding disproportionate outcomes to paragraph 100.3 A2 of the body of the Code and the material on ethical conflict resolution to paragraphs 110.3 A2 and 110.A3 of the body of the Code. In addition, the IESBA decided to add into paragraphs 9 and 10 of the Guide material to clarify the designation of requirements with an ‘R’ and the designation of their relationship to any specific exceptions and into paragraphs 7 and 8 more material in the How to Use the Code Section of the Guide to explain that:
 - All of the requirements and application material are to be read and applied in the context of complying with the fundamental principles, applying the conceptual framework and, in relation to audit, review and other assurance engagements, being independent;
 - Proper application of a particular section of the Code requires knowledge and understanding of the relevant section and the entire text of Part 1. The requirements and application material set out in any subsection are to be read in conjunction with the requirements and application material set out in the related section.
26. The IESBA determined to include a reference in the Code to explain its use of “might” and “may” and also included these words as described terms in the Glossary.

Navigability

27. There was widespread support from respondents concerning the navigability of the proposed restructured Code. The underlying principles behind the numbering system were broadly supported as being simple, clear, adequate, more navigable and similar to other standards and codes. Respondents had mixed views about the proposed numbering system in Structure ED-1. There was no general consensus proposal among respondents who did not support the numbering system as to what the numbering system should be. Other respondents made suggestions for further improvements including:
 - Raising the profile of the fundamental principles and the IIS. They proposed giving the IIS a more prominent title than “C1” and “C2.”
 - The use of bold font or other highlighting for requirements.
 - Keeping subsections to a minimum and addressing where the link with the overall section is either unclear or weak.

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28. The IESBA noted the widespread support from respondents and considered the comments and suggestions. To address the suggestions made the IESBA agreed to rename the various parts of the Code as follows:
- Part 1 – Complying with the Code, fundamental principles and conceptual framework (Sections 100 to 199).
 - Part 2 – Professional Accountants in Business – (Sections 200 to 299).
 - Part 3 – Professional Accountants in Public Practice – (Sections 300 to 399).
 - International Independence Standards
 - Part 4A – Independence for Audits and Reviews (Sections 400 to 899).
 - Part 4B – *Independence for Other Assurance Engagements* (Sections 900 to 999)
29. The IESBA reaffirmed its view that the numbering system in Structure ED-1 is appropriate because it accomplished a number of objectives including reasonable simplicity; the visibility of requirements and their related application material; and the ease of adding of future material, both when adding to an existing section and when introducing new sections. It also concluded that the use of the prefix “R” and the suffix “A” sufficiently differentiated requirements from application material.

Audit Includes Review

30. Structure ED-1 proposed placing most definitions and descriptions in the Glossary, including words that were included in the “Terms Used.” It proposed that descriptions from the Glossary be included in the body of the text and be denoted by a footnote the first time that they occur in a Section.
31. A term that is included in the Glossary in this way is “audit” where it is intended to include “review” for the purposes of the IIS. There was widespread support from stakeholders who commented on “audit” including “review.” Some respondents emphasized that clarification of the term “audit” includes “review” should remain in the body of the Code in addition to its inclusion in the Glossary and should not be limited to a footnote. Some respondents expressed the view that distinguishing audits from reviews enhanced clarity. A respondent suggested that the restructured Code state that C1 (Part 4B) equally applies to review engagements instead of mentioning that the audit engagement includes the review.

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32. The IESBA agreed that:
- Certain terms should be included in both the Glossary and the body of the Code.
 - It is appropriate for the proposed restructured Code to deal with audits and reviews in the same standards, and that this be disclosed in the body of the Code.
 - The proposed restructured Code should state that the standards apply equally to audit and review engagements noting that stakeholders, if they so wished, could choose to distinguish “audit” and “review” separately in domestic versions of their Code.

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- That descriptions would be included in the body of the proposed restructured Code when they first appeared rather than being denoted by a footnote.

Title

33. Structure ED-1 proposed that the proposed restructured Code be titled *International Code of Ethics Standards for Professional Accountants*. Respondents were supportive of inclusion of the word “International” in the title. However, views on other elements of the title varied, with a few respondents finding the proposed title cumbersome and several respondents expressing particular concern about combining the two terms “Code” and “Standards.”

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34. The IESBA determined that the new title be:

International Code of Ethics for Professional Accountants

with the notation

(including International Independence Standards)

included under the title. The IESBA determined not to accept retention of the existing title because it does not include the word “international” which is an important attribute of the Code. The IESBA determined that using the above title retained the principles-based approach of the Code while notation emphasized that the Code included standards.

Exceptions

35. A few respondents made a suggestion for that permitted exceptions to requirements in the Code be included in or adjacent to the relevant requirement.

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36. The IESBA determined that:

- Exceptions be located as close as possible to the related requirement, with only necessary application material in between.
- Requirements be linked to their exceptions by the use of the words “subject to” and that exceptions be linked to their requirements by the use of the phrase “as an exception to” so as to improve the clarity of the Code.

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Agenda Item 3-G
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**International
Ethics Standards
Board for Accountants®**

529 Fifth Avenue, New York, NY 10017
T + 1 (212) 286-9344 F +1 (212) 286-9570
www.ethicsboard.org