

Exposure Draft

[January 2017]

Comments due: [May 25, 2017]

Note to Meeting Participants

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

*International Ethics Standards Board for
Accountants®*

**Improving the Structure of the
Code of Ethics for
Professional Accountants—
Phase 2 with Certain
Proposed Conforming
Amendments Arising from the
Safeguards Project**

This Exposure Draft was developed and approved by 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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REQUEST FOR COMMENTS

This Exposure Draft, *Improving the Structure of the Code of Ethics for Professional Accountants—Phase 2 with Certain Conforming Amendments Arising from the Safeguards Project*, (Structure ED-2) was developed and approved by the International Ethics Standards Board for Accountants® (IESBA®). This document describes key features of Phase 2 of the Structure project and explains the rationale for IESBA's proposals. It also includes conforming amendments arising from the Safeguards project. These conforming amendments are presented in gray text. Additional detail about IESBA's decisions with respect to restructuring is provided in the *Basis for Agreement-in-Principle for Improving the Structure of the Code of Ethics for Professional Accountants—Phase 1* [insert hyperlink] (The Basis for Agreement-in-Principle for Phase 1). The Basis for Agreement in Principle for Phase 1 explains the rationale for the changes to the Exposure Draft *Improving the Structure of the Code of Ethics for Professional Accountants—Phase 1* (Structure ED-1). The Explanatory Memorandum to the Exposure Draft, *Proposed Revisions Pertaining to Safeguards in the Code—Phase 2* [insert hyperlink] explains the rationale for the proposed conforming amendments arising from the Safeguards project.

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. Comments are requested by **[May 25, 2017]**.

Respondents are asked to submit their comments electronically through the IESBA website, using the [“Submit a Comment”](#) link. Please submit comments in both PDF and Word files. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. Although IESBA prefers that comments are submitted via its website, comments can also be sent to Ken Siong, IESBA Technical Director at KenSiong@ethicsboard.org

This publication may be downloaded from the IESBA website: www.ethicsboard.org. The approved text is published in the English language.

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EXPLANATORY MEMORANDUM

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. This memorandum provides background to, and an explanation of, the proposed text in Phase 2 of the Structure of the Code project. The IESBA approved this Exposure Draft (ED): *Improving the Structure of the Code of Ethics for Professional Accountants—Phase 2 with Certain Conforming Amendments Arising from the Safeguards Project* (Structure ED-2) in December 2016.

II. Background

3. The IESBA published proposals in its December 2015 ED, [Improving the Structure of the Code of Ethics for Professional Accountants—Phase 1](#) (Structure ED-1). This ED comprised: a Table of Contents; a new Guide to the Code; a restructured extant Part A of the Code;¹ and a restructured part of extant Part B² of the Code. 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 and other professional organizations, and others.
4. There was widespread support for the key features of the restructuring, including the principles basis, requirements distinguished from application material, enhanced clarity and overall usability. Respondents appreciated that 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. At its December 2016 meeting the IESBA agreed-in-principle the revisions to Structure ED-1. The IESBA has published concurrently with this memorandum a Basis for Agreement-in-Principle which is discussed in Section III of this memorandum.
5. While expressing support for ED-1, a number of respondents requested the opportunity to have the complete proposed restructured Code available when reviewing Structure ED-2. To assist readers in better understanding how the provisions of Phases 1 and 2 of the Structure of the Code Project (the Structure Project) relate to each other, and to the work of the Safeguards Project, a staff-prepared compilation of the complete text of the proposed restructured Code (Phases 1 and 2) [\[insert hyperlink\]](#) and a mapping table [\[insert hyperlink\]](#) are available to facilitate tracking of the changes from the extant Code to the proposed restructured Code. In addition, to assist review from the restructured Code back to the extant Code, the IESBA has added comments against each paragraph of the staff compilation to explain its derivation, i.e., whether it is from a particular paragraph in the extant Code or new material.

¹ Part A – *General Application of the Code*

² Part B – *Professional Accountants in Public Practice*, Sections 200 to 290 (excluding paragraphs 290.500 to 290.514 *Reports that Include a Restriction on Use and Distribution*)

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6. Structure ED-2 comprises the restructuring of the text of several IESBA projects representing the majority of the remainder of the extant Code as follows:
- Chapter 1–Proposed Restructured Text of the [Close-off Document for Part C Phase 1](#)³ (Sections 200-270)
 - Chapter 2–Proposed Restructured Text of the final NOCLAR provisions, [Responding to Non-compliance with Laws and Regulations](#)⁴ (Sections 260 and 360)
 - Chapter 3–Proposed Restructured Text of the Revised Provisions Regarding Long Association (LA)⁵ [\[insert hyperlink\]](#) (Sections 540 and 940)
 - Chapter 4–Proposed Restructured text of the Provisions Addressing Restricted Use Reports⁶ (Section 800)
 - Chapter 5–Proposed Restructured Text Relating to Independence – Other Assurance Engagements (Part 4B)⁷

For a complete list of the contents of Structure ED-1 and Structure ED-2 see the table of contents set out on [pages X to Y] below.

7. Proposed Section 600, *Provision of Non-assurance Services to an Audit Client* and Proposed Section 950, *Provision of Non-assurance Services to an Assurance Client* form part of the IESBA's Safeguards project scope and are subject to revisions that go beyond the scope of the Structure project. However, those sections have been revised using the new structure and drafting conventions for the proposed restructure Code. The proposed text for Sections 600 and 950 are set out in the Exposure Draft, *Proposed Revisions Pertaining to Safeguards in the Code – Phase 2* [\[insert hyperlink\]](#). The IESBA welcome feedback about matters pertaining to the structure and drafting convention used in those sections in response to this ED.
8. The IESBA has discussed this project with its Consultative Advisory Group throughout this project.

III. Key Features of the Proposed Restructured Code

9. The Phase 1 text of the restructured Code was agreed in principle by the Board at its December 2016 meeting. A Basis for Agreement-in-Principle has been prepared which explains the rationale for the Board's final conclusions on Phase 1 of the Structure project and sets out key elements and other highlights of the restructuring. The IESBA does not intend to make any changes to the text agreed in principle unless required to address consistency between the texts of Structure ED-2 and Structure ED-1.

³ Proposed Restructured Code, Sections 200 to 299 – *Professional Accountants in Business*

⁴ Proposed Restructured Code Sections 260 and 360 – *Responding to Non-compliance with Laws and Regulations*

⁵ Proposed Restructured Code, Section 540 *Long Association of Personnel (Including Partner Rotation) with an Audit Client*; and Section 940 *Long Association of Personnel with an Assurance Client*

⁶ Proposed Restructured Code Section 800 – *Reports that Include a Restriction on Use and Distribution*, Extant Code Paragraphs 290.500 to 290.514 – *Reports that Include a Restriction on Use and Distribution*

⁷ Extant Code Section 291 *Independence – Other Assurance Engagements*

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Key Elements of the Restructuring

10. 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.
11. 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:
 - o Each Section having its own introduction which broadly describes the context, including the threats that might exist, and referencing the fundamental principles.
 - o Revised numbering to facilitate revisions.
 - (d) Reversal of extant Parts B⁸ and C⁹ 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)*.¹⁰
 - (f) Definitions section enhanced and presented as a glossary, which also includes descriptions of terms used.
 - (g) A new title for the Code.

⁸ Extant Part B – *Professional Accountants in Public Practice*

⁹ Extant Part C – *Professional Accountants in Business*

¹⁰ 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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Matters for Future Board Attention

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

Electronic Code and Future Tools

13. The IESBA believes that the proposals in this ED will help position the Code for further enhancements to navigability. Development of further electronic features and tools to assist navigability and implementation will be considered after the Code has been restructured. Such features might include filtering options and enhancements to the navigability of the current electronic Code. Terms in the Glossary will be electronically linked to the body of the Code.

IV. Significant Matters

14. The project scope encompasses the entire Code. This exposure draft aligns the Structure ED-2 proposed restructured Code material with the key features of Structure ED-1 described in paragraphs 9 to 11 of Section III of this memorandum.
15. The IESBA has reviewed all proposed changes for consistency with the objectives of the restructuring including consistency with Structure ED-1. These changes are 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 IESBA has made significant effort to avoid inadvertent changes in the meaning of the Code. It has also sought to avoid inadvertent reduction in requirements or other weakening of the Code.
16. In addition to proposed restructured material a separate ED has been issued regarding the scope of the material set out in Chapter 1. [Insert Hyperlink to Part C Applicability ED]
17. In addition to having been redrafted in line with Structure ED-1 Chapter 4 has been modified so as to describe an engagement to issue a restricted use and distribution report (in the circumstances set out in proposed restructured Code paragraph R800.3) as an “eligible audit engagement.”
18. In addition to having been redrafted in line with Structure ED-1, Chapter 5 has been modified so as to include in proposed restructured Code paragraph 900.1 a specific reference to an audit of specific elements, accounts or items of a financial statement as being an example of an assurance engagement. The updating of Chapter 5 to conform to ISAE 3000 (Revised)¹¹ is under consideration and comments on conforming amendments will be sought at a later date.

Conforming Amendments Arising from the Safeguards Project

19. The Board’s proposals include, in gray text, conforming amendments arising from the Board’s Safeguards project. Those conforming amendments are needed throughout the Code as a result of the revisions established in Safeguards Phase 1. While the rationale for those proposed conforming amendments are included in this document, the Board is requesting input on those proposed conforming amendments in response to its Safeguards ED-2.

¹¹ International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*

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20. The conforming amendments arising from the Safeguards project, shown in gray text are to:
- (a) Drop duplicate requirements and application material that are already covered in the conceptual framework set out in Section 120. The introduction for each section of the restructured Code clarifies that the requirements and application material in the conceptual framework are also applicable.
 - (b) Replace the words “...significance of the threat...,” with “...level of the threat...”. Accordingly, the words “significance” and “significant” are no longer used to describe threats. Paragraph 120.8 A1 defines acceptable level as a level at which a PA using the reasonable and informed third party test would conclude that the accountant complies with the fundamental principles. The Board believes that the restructured Code should avoid the phrase “higher level of threat” because it is subjective and does not have commonly understood meaning, and therefore is not as clear.
 - (c) Change the extant Code examples of safeguards that are established by professional, legislation, regulation, the firm, or the employing organization to factors that are relevant in evaluating the level of threats. Examples of safeguards in the extant Code are withdrawn and characterized as certain conditions, policies and procedures established by the professional, legislation, regulation, the firm, or the employing organization that might impact the PA’s evaluation of the level of threats.
 - (d) Clarify the various types of actions that can be taken to address threats in accordance to the new requirement to address threats established as part of Safeguards Phase 1 paragraph R120.10. Matters that were characterized as examples of safeguards in the extant Code are now classified as:
 - (i) Examples of actions that might be safeguards to address a specific threats;
 - (ii) Other actions that might address the threat i.e., the actions that the PA takes to:
 - a. Eliminate the circumstances, including the interests or relationships that are creating the threat); or
 - b. Decline or end the specific professional activity.

Breaches Verses Threats to the Fundamental Principles

21. The term “breach the fundamental principles” is used differently in the extant Code. For example, in the Independence sections of the Code, the term “breaches” is used to refer to a circumstances when the PA has not complied with a specific fundamental principle. However, in Section 270, the term is used as a short-hand to threats to compliance with the fundamental principles.
22. To avoid confusion, as part of its conforming amendments, the word breaches in the restructured Code is used only to refer to a circumstance when the PA has not complied with the fundamental principles. By way of an example, the implication of this conclusion is seen in paragraphs 270.4 A2 and 270.4 A3–R270.5.

Conforming Amendments to Chapter 1, PAIBs

23. Questions have been raised about whether the requirements and application material in the

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conceptual framework set out in Section 120 should apply in a different way to PAIBs. The IESBA is of the view that the conceptual framework set out in Section 120 applies in the same way to PAIBs as it does to all other PAs. This is explained in the introduction section of Part 2 (i.e., paragraphs 200.1 – 200.4).

24. Similar to the approach taken in the general sections for the independence standards in Section 400 and 900, Section 200¹² emphasizes and in some cases repeats certain material in Sections 120 and 300 that the Board believes is helpful for PAIBs identifying, evaluating and address threats (for example, see paragraph 200.6 A1, 200.6 A2–200.7 A2).

Pressure to breach the fundamental principles

25. With respect to Section 270, paragraph 270.4 A3 lists the factors that are relevant to evaluating the level of threats created by pressure. Paragraphs 270.4 A4 and 270.4 A5 now clarify that certain matters might assist PAIBs understand those factors. Paragraph R270.5 is more closely aligned with the requirement in R120.10 and indicates that threats created by pressure can be addressed by:
- (a) Eliminating the circumstances, interests or relationships, that are creating the threats; including resigning from the employing organization;
 - (b) Applying safeguards, where available or capable of being applied; or
 - (c) Declining or ending the specific professional activity.
26. Similarly to the extant [Part C Phase 1 close-off document](#), Section 270 does not include examples of safeguards. However, it includes an example of an action that might address threats by eliminating the circumstance creating the pressure (see paragraph 270.4 A6).

V. Project Timetable and Effective Date

27. The IESBA is mindful of the need for appropriate alignment of the timing of Phases 1 and 2 of the Structure Project with the timing of other projects currently in progress. The proposed timing of Phase 2 of the Structure project has taken into account the approval dates for various sections of the Code which are currently under revision or development. For further information, see the IESBA Update, *Restructuring the Code of Ethics for Professional Accountants*.[\[insert hyperlink\]](#)
28. The IESBA proposes that Parts 1 to 3 of the proposed restructured Code be effective on June 15, 2019 and that Parts 4A and 4B (The International Independence Standards excluding Sections 540 and 940) be effective for audits of financial statements for periods beginning on or after June 15, 2019. Sections 540 and 940 will be effective for audits of financial statements for periods beginning on or after [MMDD, YYYY].
29. The IESBA encourages its stakeholders to commence translation of the Phase 1 material contained in the staff publication with immediate effect. To assist its stakeholders the IESBA plans to provide a mark-up from changes to this staff compilation to the final standard accompanied by a mapping table.

¹² Section 200, *Applying the Conceptual Framework – Professional Accountants in Business*

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VI. Guide for Respondents

30. The IESBA welcomes comments on all matters addressed in this ED, but especially those identified in the Request for Specific Comments below. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in this ED, it will be helpful for the IESBA to be made aware of this view.
31. As explained in the Background section of this memorandum, the objectives of the restructuring are to improve the understandability and usability of the Code by restructuring it without changing its meaning, except in limited circumstances where the IESBA considers this necessary. Respondents are asked to distinguish in their responses between comments on the application of the structure and drafting conventions and comments on any changes in meaning.

Request for Specific Comments

32. The IESBA welcomes views from respondents on the following matters.

Structure of the Code

1. Do you believe that the restructuring of ED 2 material has resulted in any unintended change in meaning of:
 - (a) Chapter 1–Proposed Restructured Text of the Close-off Document for Part C Phase 1 (Sections 200-270)
 - (b) Chapter 2–Proposed Restructured Text of the final NOCLAR provisions, Responding to Non-compliance with Laws and Regulations (Sections 260 and 360)
 - (c) Chapter 3–Proposed Restructured Text of the Revised Provisions Regarding Long Association (LA) [insert hyperlink] (Sections 540 and 940)
 - (d) Chapter 4–Proposed Restructured text of the Provisions Addressing Restricted Use Reports (Section 800)
 - (e) Chapter 5–Proposed Restructured Text Relating to Independence – Other Assurance Engagements (Part 4B)

If so, please explain why and suggest alternative wording.

2. Do you agree that the proposed text is consistent with the key elements of the restructuring as described in paragraphs 9 to 11 above.
3. Do you agree with the proposed effective date? If not, please indicate why not and explain your reasoning.

Conforming Amendments Arising from the Safeguards Project

4. Do respondents agree with proposed conforming amendments arising from the Safeguards project (i.e., the proposed text shaded in gray)?
5. Respondents are asked to comment on any other matters that are relevant to Phase 2 of the Safeguards project more broadly.

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Request for General Comments

33. In addition to the request for specific comments above, the IESBA is also seeking comments on the matters set out below:
- (a) *SMPs* – The IESBA invites comments regarding the impact of the proposed changes for SMPs.
 - (b) *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the Code, the IESBA invites respondents from these nations to comment on the proposals, and in particular, on any foreseeable difficulties in applying them in their environment.
 - (c) *Translations*—Recognizing that many respondents may intend to translate the final pronouncement for adoption in their environments, the IESBA welcomes comment on potential translation issues respondents may note in reviewing the proposals.

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PROPOSED RESTRUCTURED CODE (PHASE 2)

This ED sets out proposed revisions to the Code developed by the IESBA in the course of its Structure of the Code project. Comment boxes next to the paragraphs identify their source in the extant Code or indicate whether they are new material.

The January 2016 [*ED, Proposed Revisions Pertaining to Safeguards in the Code—Phase 2*](#) (Safeguards ED-2) sets out proposed revisions to the Code developed by the IESBA in the course of its Safeguards project. For convenience, the conforming amendments arising from the Safeguards proposals are included in this ED and are shaded in gray. The Board requests input on those proposed conforming amendments in response to Safeguards ED-2.

[Final text of proposals to follow]

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