

**Exposure Draft**

[January 2017]

*Comments due: May DD, 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®*

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**Proposed Revisions to Clarify  
the Applicability of Provisions  
in Part C of the Extant Code  
to Professional Accountants in  
Public Practice**



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, Proposed Revisions to Clarify *the Applicability of Provisions in Part C of the Extant Code to Professional Accountants in Public Practice* was developed and approved by the International Ethics Standards Board for Accountants® (IESBA®).

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 [DD], 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](mailto:KenSiong@ethicsboard.org)

This publication may be downloaded from the IESBA website: [www.ethicsboard.org](http://www.ethicsboard.org). The approved text is published in the English language.

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EXPLANATORY MEMORANDUM

## I. Introduction

1. This Explanatory Memorandum (EM) provides background to, and an explanation of, the IESBA's proposal to clarify the applicability of Part C–Professional Accountants in Business (PAIBs) of the extant Code to professional accountants in public practice (PAPPs). The Board approved these proposed changes for exposure at its December 2016 meeting.
2. In November/ December 2015, the IESBA approved Phase 1 of its Revision of Part C project, changes to Part C of the *Code of Ethics for Professional Accountants* (the Code) addressing the preparation and presentation of information, and pressure to breach the fundamental principles<sup>1</sup> under the extant structure and drafting conventions of the Code (“close-off document”). The revised provisions in the close-off document are not yet effective. The effective date will be the same as the restructured Code. The close-off document has been restructured and approved for exposure as part of the IESBA's December 2016, Exposure Draft: *Improving the Structure of the Code of Ethics for Professional Accountants – Phase 2* and is set out in Appendix 2 to this EM. It is planned that those revised provisions for PAIBs will be released in its restructured format with the full restructured Code. Accordingly, the effective date for those revised provisions will be the same as the Structure of the Code project.
3. Phase 2 of the Revision of Part C project<sup>2</sup> relate to revising extant Section 350, *Inducements*<sup>3</sup> and is expected to be approved for exposure in 2017.

## II. Background

4. In 2012, the IESBA commenced work with the aim of exploring whether Part C needed to be strengthened to better promote ethical behavior by PAIBs. In March 2013, the IESBA approved a project to address these matters in two separate phases. In finalizing Phase 1 of the project, questions were raised about the applicability of provisions in Part C of the extant Code (restructured Part 2).
5. The IESBA considered that guidance within the extant Code<sup>4</sup> could be interpreted, at least implicitly, to mean that the Code contains two distinct parts (i.e., Part B<sup>5</sup> and Part C) directed at two different categories of professional accountants, with provisions in each part aimed at addressing the ethical issues that each category of professional accountant might encounter. However, the extant Code notes that in certain circumstances the provisions for PAIBs may be relevant to PAPPs. Paragraphs 100.3 and 100.12 of the Code each contain a sentence that states “...professional accountants in public practice *may* also find Part C relevant to their particular circumstances.”

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<sup>1</sup> The close-off document is available at: [www.ethicsboard.org/system/files/meetings/files/Agenda-Item-D-3.1-Part-C-Phase-1-Close-Off-Document.pdf](http://www.ethicsboard.org/system/files/meetings/files/Agenda-Item-D-3.1-Part-C-Phase-1-Close-Off-Document.pdf)

<sup>2</sup> Phase 2 also involves a review Section 350 of the extant Code, *Inducements*.

<sup>3</sup> Proposed Restructured, Section 250, *Inducements*

<sup>4</sup> Paragraph of Section 200.1 of the extant Code, states that “This part [Part B] of the Code describes how the conceptual framework contained in Part A applies in certain situations to professional accountants in public practice”.

Paragraph 300.1 of the extant Code states that “This part [Part C] of the Code describes how the conceptual framework contained in Part A applies in certain situations to professional accountants in business”.

<sup>5</sup> Extant Part B, *Professional Accountants in Public Practice*

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6. The Board noted that questions can be raised about the intended meaning of the statement in paragraphs 100.3 and 100.12, and how a professional accountant should apply it. For example, the use of the word “may” rather than “shall” in the sentence might lead a PAPP to conclude that compliance with the provisions in Part C is optional. Also, the Board noted that the statements are not in a prominent location in the extant Code.

### III. Significant Matters

#### Applicability of the Provisions in Part C (Restructured Part 2) to PAPPs

7. The Board concluded that it is possible for PAPPs to find themselves in ethically problematic circumstances that do not involve clients and hence face the same issues and ethical dilemmas as PAIBs. Accordingly, the Board agreed to developed clarifications to explain whether there are circumstances in which the provisions in Part C of the extant Code (restructured Part 2) should also apply to PAPPs.
8. In its deliberation, the IESBA considered that Part 2 of the restructured Code focuses on issues relating to professional accountants as employees or contractors of organizations and addresses both internal issues within the employing organization and also business relationships with external parties. Part B (restructured Part 3) addresses issues pertaining to the relationships between PAPPs and their clients. In considering applicability, the Board focused on the following three specific areas in Part 2:
  - (a) Conflicts of Interest;
  - (b) Pressure; and
  - (c) Inducements.

#### *Conflicts of Interest*

9. The extant Code includes requirements and application material for conflicts of interest in both Parts B and C. In extant Part B, the provisions pertain to potential conflicts a professional accountant might have with clients. In extant Part C the provisions pertain to potential conflicts a professional accountant might have when performing work for an employing organization. The IESBA is of the view that that the provisions in extant Part C of the Code might be relevant to PAPPs as they are also susceptible to conflict of interest situations within their employing organizations (i.e., the accounting firm) or with external parties, other than their clients. The IESBA's reaffirmed its conclusions with respect to Parts 2 (for PAIBs) and 3 (for PAPPs) of the restructured Code.

#### *Pressure*

10. Threats to compliance with the fundamental principles may arise as a result of “undue pressure” from a variety of situations. Extant Section 370<sup>6</sup> deals explicitly with this issue. Corresponding guidance does not exist in extant Part B (restructured Part 3). Accordingly, the only guidance within the Code that addresses undue pressure, the threats it poses to compliance with the fundamental principles and how such threats can be addressed, is in extant Part C (restructured Part 2).

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<sup>6</sup> Extant 370, *Pressure to Breach the Fundamental Principles* is a new section and is included in the close-off document which is available at: [www.ethicsboard.org/system/files/meetings/files/Agenda-Item-D-3.1-Part-C-Phase-1-Close-Off-Document.pdf](http://www.ethicsboard.org/system/files/meetings/files/Agenda-Item-D-3.1-Part-C-Phase-1-Close-Off-Document.pdf)

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11. The following are examples of situations where the requirements and application material in Part 2 might be applicable to PAPPs:
- PAPPs may be inappropriately pressured by superiors to compromise audit quality by working within unrealistic time budgets.
  - A division of a firm is pressured by another division of the firm to retain an untrustworthy client, solely to protect the larger fee income of the latter division.
  - A firm's internal accounting staff might be pressured to tailor the firm's results so that profit shares for partners are distorted towards one individual or group of partners.

*Inducements*

12. Inducements may take various forms including gifts, hospitality, preferential treatment, and inappropriate appeals to friendship or loyalty. The extant Code includes provisions regarding inducements for PAIBs and for PAPPs. However, the provisions for PAPPs in Part B<sup>7</sup> the extant Code only addresses inducements that a PAPP may receive from a client. Those for PAIBs in Part C<sup>8</sup> also deal with the topic of inducements more broadly and address:
- The receipt of offers from external parties, and
  - Internal pressure from within the employing organization to offer inducements to external stakeholders that are not clients.
13. The IESBA is of the view that in certain situations the requirements and application material relating to inducements for PAIBs in extant Part C, in particular those that relate to how PAIBs should deal with internal pressure from within the employing organization to offer inducements, might also be relevant to PAPPs. As stated at paragraph 3 to this EM, the IESBA is in the process of enhancing the section of the extant Code relating to inducements. Those enhancements may also be applicable to PAPPs.

**Options Considered**

14. In developing its proposals, the IESBA considered three possible options:
- (a) Duplicate the requirements and application material in extant Part C (restructured Part 2) for PAIBs in extant Part B (restructured Part 3) for PAPPs;
  - (b) Amend or clarify the definition of a PAIB; or
  - (c) Clarify that the requirements and application material in the Code should be applied in a holistic manner.
15. After deliberating the pros and cons of each option, the IESBA concluded that the holistic approach would be the best option. Specifically the IESBA agreed to require that PAPPs consider the context within which the ethical issue has occurred (e.g. not only in relation to clients, but also within the employing organization or in relation to external parties other than clients) and then to consult relevant

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<sup>7</sup> Section 260, *Gifts and Hospitality*

<sup>8</sup> Section 350, *Inducements*. The IESBA plans to consider revisions to the provisions in Section 350 as part of its Phase 2 work.

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requirements and application material, irrespective of the specific location (i.e., which part of the Code) of such requirements and application material.

16. Devising a holistic approach to the Code is the IESBA's preference because it:
  - (a) Ensures that PAPPs consider the provisions in Part C to determine whether they are applicable;
  - (b) Would not involve an excessive amount of time and resources to implement, as the professional accountant would be tasked with deciding which sections of the Code need to be referred to; and
  - (c) Does not create an unwieldy Code with duplicate requirements and application material relating to the same topic, thus deviating from one of the objectives of the Structure of the Code project.
17. In drafting the proposed "applicability paragraphs" the IESBA considered incorporating a summary of the ethical issues on which a PAPP might consider referring to guidance in extant Part C (restructured Part 2). The Board opted against this approach and concluded that highlighting specific sections in Part C is not needed because all the requirements and application material in Part C (restructured Part 2) should be considered by a PAPP. The Board was also concerned that references to specific sections, but not all of Part C (restructured Part 2) might result in a PAPP inadvertently overlooking requirements and application material that might be relevant based on the facts and circumstances.
18. However, the IESBA believes that the objective of the paragraphs, namely to indicate the manner in which ethical duties are discharged in situations where the PAPP is not providing services to clients, would be enhanced by including an example to the proposed wording that explains a situation where the PAPP might face an ethical dilemma that is not client-related.

*Feedback on Structure ED-1*

2. In developing refinements, the Board also considered input from some respondents to the December 2015 Exposure Draft, *Improving the Structure of the Code of Ethics for Professional Accountants – Phase 1* (Structure ED-1) relevant to the topic.<sup>9</sup> One of those respondents suggested that the IESBA consider repositioning the following sentence that was presented in paragraph 4 of the Guide to the proposed restructured Code to the body of the Code itself to ensure it is not overlooked:

"Professional accountants in public practice might also find [extant] Part C [i.e., restructured Part B] relevant to their particular circumstances."
19. The Board is of the view that its proposal is responsive to those respondents' comment.

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<sup>9</sup> The IESBA did not deal with issues related to the applicability of Part C to PAPPs in its Structure ED-1. However, the following proposals are relevant to the issue:

- The sentence in paragraph 100.3 ("Professional accountants in public practice may also find Part C relevant to their particular circumstances") of the extant Code has been repositioned to the Guide; and
- The Explanatory Memorandum to Structure ED-1 noted that the order of Parts B and C of the extant Code would be reversed, with "Part C" retitled to be proposed "Part B".



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**Location of “Applicability Paragraphs”**

20. The IESBA considered whether to place the “applicability paragraphs” in extant Part A<sup>10</sup> (restructured Part 1) only. However, this approach bears a risk that it might be overlooked by users of the Code who consult only Part B (restructured Part 3) when seeking guidance. The Board also considered having the “applicability paragraphs” in Part A, with the inclusion of a reference in Part B to direct readers to the new provisions, so as to avoid duplication of the same material in two parts of the restructured Code. However, in this case, the Board has opted to have the “applicability paragraphs” in both Parts 1 (extant Part A) and Part 3 (extant Part B) because:
- (a) The need to clarify applicability of the requirements and application material in Part 2 (extant Part C) to PAPPs is sufficiently important to highlight it in both Parts 1 (extant Part A) and 3 (extant Part B).
  - (b) An adequately drafted reference paragraph would not be much shorter than repeating the full “applicability paragraphs”; hence the benefit of streamlining the material in the restructured Code is limited.
21. The IESBA also agreed to include a reference to the “applicability paragraphs” in the Guide to the proposed restructured Code.
22. The proposed “applicability paragraphs” are drafted using the new structure and drafting conventions of the restructured Code.

*“Applicability Paragraphs” in Part 1 for All PAs*

23. On review of the Part 1 of the restructured Code and consideration of possible alternatives, the IESBA’s preferred locations for the “applicability paragraphs” are after paragraph 120.3 A1.<sup>11</sup> Section 120 has been given more prominence in the proposed restructured Code and hence will likely be the most utilized Section. Paragraph 120.3 A1 includes new application guidance on the nature of the standards within each part of the Code and notes that the conceptual framework applies to all professional accountants.

*“Applicability Paragraphs” in Part 3 for PAPPs*

24. The IESBA is of the view that the “applicability paragraphs” should be placed within Part 3 for PAPPs,

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<sup>10</sup> Part A, *Introduction to the Code and Fundamental Principles*

<sup>11</sup> Paragraph 120.3 A1 of proposed Section 120 states that:

“Additional requirements and application material that are relevant to the application of the conceptual framework are set out in:

- (a) Part 2 – *Professional Accountants in Business*;
- (b) Part 3 – *Professional Accountants in Public Practice*; and
- (c) *International Independence Standards* as follows:
  - (i) Part 4A – *Independence for Audits and Reviews*; and
  - (ii) Part 4B – *Independence for Other Assurance Engagements*.”

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specifically in Section 300<sup>12</sup> in order to clarify to a PAPP that the consideration of the provisions within the restructured Code should not be limited to the material in Part 3 and that the provisions in Part 2 might also be relevant and therefore applicable to PAPPs.

25. The provisions in restructured Section 300 focus on describing considerations for PAPPs to apply the conceptual framework. While, there is no obvious positioning within Section 300 for the “applicability paragraphs,” the IESBA’s proposed “applicability paragraphs” are set out after paragraph R300.4,<sup>13</sup> immediately after reference is made to the conceptual framework.

**Other Matters**

*Adoption of the “Applicability Paragraphs”*

26. The IESBA noted from its National Standard Setters (NSS) Liaison Group that in some jurisdictions<sup>14</sup> PAIBs are not members of the national professional accountancy organization (PAO). Accordingly, only the requirements and application material in extant Parts A and B (Parts 1 and 3 of the restructured Code) are adopted or relevant. Therefore, the addition of the “applicability paragraphs” would require members of the PAO to consider additional provisions to which they had not previously given any attention.
27. IESBA members noted this some local PAOs did not include PAIBs within their remit, and in some cases were in the process of converging their ethical codes to align the IESBA Code, a process which might mean that the requirements and application material in extant Part C might eventually be incorporated into those local codes. The IESBA accepts that the inclusion of the “applicability paragraphs” in the Code might be an issue for a few jurisdictions. However, it believes that its proposal for PAPPs to consider the applicability and relevance of requirements and application material in of the Part 2 of the restructured Code enhances the Code, thereby making it more robust. The Board is of the view that setting the same high quality ethical standards for all professional accountants justifies the additional requirements and application material that might be needed for PAPPs.

**IV. Project Timetable and Effective Date**

28. The IESBA intends to align the effective date of the proposals relating to the “applicability paragraphs” with the proposed timing of the Structure of the Code project, and the effective date of the restructured Code.
29. The December 2016, *IESBA Update* outlines the IESBA’s plan for coordination of its various work streams that will result in the restructure Code.

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<sup>12</sup> Section 300, *Application of the Conceptual Framework for Professional Accountants in Public Practice*

<sup>13</sup> Paragraph R300.4 of proposed Section 300 states that “A professional accountant shall comply with each of the fundamental principles and apply the conceptual framework set out in Section 120 to eliminate threats to compliance with those fundamental principles or to reduce them to an acceptable level.”

<sup>14</sup> For example, in France, the French Institute adopted only extant Parts A and B. Consequently, the requirements in extant Part C are not applicable to PAPPs.

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**V. Guide for Respondents**

30. The IESBA welcomes comments on all matters addressed in this exposure draft (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.

**Request for Specific Comments**

1. Do respondents support the IESBA's proposals that PAPPs shall obtain an understanding of the provisions in Part 2 and comply with them?
2. If respondents agree with the planned approach for moving forward, respondents are asked for their views on:
  - (a) The proposed "applicability paragraphs;" and
  - (b) The proposed positioning of the "applicability paragraphs" in the Code.

**Request for General Comments**

31. In addition to the request for specific comments above, the IESBA is also seeking comments on the matters set out below:
- (a) Small and Medium Practices (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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**Appendix**

[Placeholder for placement of the full text of *Part 2 – Professional Accountants in Business* that forms part of Structure ED-2 for respondents' reference]

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[Placeholder for placement of proposed text for exposure (i.e., “applicability paragraphs” in Parts 1 and 3 restructure Code)]

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