

May 25, 2017

## **IFAC Small and Medium Practices (SMP) Committee Response to the International Ethics Standards Board for Accountants (IESBA) Exposure Draft: *Improving the Structure of the Code of Ethics for Professional Accountants—Phase 2***

### **INTRODUCTION**

The SMP Committee is pleased to respond to the IESBA (the Board) on this Exposure Draft (ED).

The SMP Committee is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small-and medium-sized entities (SMEs). The constituents of the SMP Committee are small-and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members of the SMP Committee have substantial experience within the accounting profession, especially in dealing with issues pertaining to SMEs, and are drawn from IFAC member bodies representing 22 countries from all regions of the world.

### **GENERAL COMMENTS**

The SMP Committee has been grateful for the opportunity to provide comments on the Structure of the Code project in advance of the IESBA Board meetings and previously submitted a [comment letter](#) in response to the consultation for Phase 1 of the Structure of the Code project in April 2016.

We continue to support the approach taken by the IESBA and the general direction of the project to improve the structure, understandability and usability of the *Code of Ethics for Professional Accountants* (the Code).

In previous comment letters, we have strongly encouraged the IESBA to consider using less conventional ways of eliciting feedback and comments on its restructuring proposals, to obtain input from the largest possible number of SMPs who are one of the main user groups of the Code. Due to their often limited resources, SMPs are often not able to easily respond and engage with the standard setting consultation process. This demands actively seeking out their views, rather than waiting for them to respond to often complex and long exposure drafts and consultation papers. We duly hope the number of SMP responses for Phase 2 will increase and have promoted the ED on social media, as well as an article on the Global Knowledge Gateway - [Final Restructuring Proposal for the Code of Ethics: What Do You Think?](#).

The “mock-up” version of the restructured Code prepared by the IESBA staff was very helpful, if not essential, to those wishing to comment on the ED, as the interaction of multiple projects in two phases makes following the IESBA’s proposals difficult. In our view, the document does show that the Code is, in general, becoming increasingly lengthy and repetitive in places (e.g., the requirement for Professional Accountants [PAs] to comply with the fundamental principles), and should thus, be limited to what is really essential.



We continue to emphasize that the Code should always prioritize attainment of ethical behavior through application of principles rather than mere prescription. For a global code, this will assist wider compliance rates, as it allows the Code to work in conjunction with various other national requirements.

In general, the Board appears to still have some work to be completed in terms of the consistency of approach (i.e. on how the Code is being re-structured) and the use of revised wording. The work undertaken to further increase clarity of the language and the consistency of text should help the understandability of the Code. In particular, the simple and shorter sentences and increased use of the active voice are helpful. As highlighted in our comment letter for the Phase 1 of the Structure project, the length and complexity of some of the sentences in the Code has caused difficulties for some SMPs (especially the non-native English speakers) and thus, makes comprehension and translation difficult.

## **SPECIFIC COMMENTS**

We have outlined our responses to each question (*in italics*) in the ED below.

1. *Do you believe that the proposals in this ED have resulted in any unintended changes in meaning of:*

- *The provisions for Part C of the extant Code as revised in the close-off document for Part C Phase 1?*
- *The NOCLAR provisions?*
- *The revised provisions regarding long association?*
- *The provisions addressing restricted use reports in the extant Code?*
- *The provisions relating to independence for other assurance engagements (Part 4B)?*

*If so, please explain why and suggest alternative wording.*

We have identified a few areas from the proposals in the ED which we believe require further consideration by the Board.

### **Revised Wording**

Some paragraphs within the extant Code are clearer than the corresponding proposed restructured requirements. This is particularly true with the International Independence Standards. For example, extant 290.508 states that "... the relevant provisions ... apply only to the members of the engagement team, their immediate family members and close family members". The limitation on such application is precise. In contrast, the proposed requirement R800.9 (a) amends this to read: "... need only apply to ...". This revised text could be interpreted as setting a minimum, but it may also imply that the application is not necessary limited to the person listed therein. There are other instances where the phrase "does not need to ...." is proposed (see R800.7 and R999.7), going beyond the extant corresponding wording. We suggest the word "need" be deleted in such instances, to be more precise.

In proposed 540.19 A1 IESBA has replaced the term "senior or managing partner" with "chief executive or equivalent". This may be less readily understood in some jurisdictions.



*2. Do you believe that the proposals are consistent with the key elements of the restructuring as described in Section III of this Explanatory Memorandum?*

We have identified a number of areas from the proposals in the ED which we believe require further consideration by the Board. These are mainly dealing with the restructured elements and the agreed drafting conventions.

### **Clarification of Responsible Party**

We understand that one of the expected outcomes of the Structure Project is to add clarity where certain responsibilities lie. The Code is, however, designed for application by individuals, who are professional accountants, not for firms. The extant Code uses phrases such as: “members of audit teams, firms and network firms” (see 290.4 and 290.1) in relation to independence. The proposed International Independence Standards in the restructured Code refer only to firms. In our view, some of the compliance with fundamental principles can only be achieved by individuals, such that the firm’s responsibilities extend to ensuring its partners and staff e.g., exercise due care etc. Hence, we suggest rather than drafting all requirements for firms, such clarification or a distinction between the firm and its personnel may be necessary to get the message across.

### **Repeated Reference to Overall Requirement**

As an introduction to each individual section, it is proposed that the sentence “Professional accountants are required to comply with the fundamental principles and apply the conceptual framework to identify, evaluate and address threats” is being repeated. In our opinion, this overriding requirement is clear in R200.5. It is therefore questionable whether there is a need for such recurring sentences throughout the Code. It makes the Code longer and is also unlikely to have an impact on expected ethical behavior.

### **Drafting Inconsistency**

There is a lack of consistency in drafting the second sentence of the introductory sections dealing with specific circumstances. In some cases these paragraphs state the nature of the threat, but do not clarify which of the fundamental principles’ compliance might be threatened (e.g., 220.2, 270.2). In others, both the nature of the threat and compliance with the fundamental principle(s) which might be threatened are stated (e.g., 210.2, 230.2, 240.2). In others, only compliance with the fundamental principle(s) which might be threatened are stated, but not the nature of the threat (e.g., 260.2). Clarity and understanding might be improved if this were dealt with in a consistent manner.

The overriding requirement pertaining to threats to compliance with the Code’s fundamental principles is threefold: to identify any threat, to evaluate such threats and to address as appropriate such threat. As far as Section 200 is concerned, this is particularly significant in regard to the overarching requirement in R200.5 as the subsequent application material covers identifying threats (200.6 A1) and evaluating threats (200.6 A2-A4). Yet, conspicuously, the addressing of threats is not highlighted. This is in contrast with the approach in Section 300 which covers identifying, evaluating and addressing the threats, as appropriate.



The inconsistent use of bold sub headings is also confusing. For example, the heading “Communicating with those charged with governance” is not bold in Section 200, but is bold in Section 300.

Throughout the ED, various iterations are used when drafting the term “using a third party to review the work of the professional accountants”, which are supposed to convey the same outcome. We recognize these are for different situations and types of service offerings, but it may be helpful if these could be more standardized. Some of the examples are:

Para in the Code	Wording
900.32 A1	Having a professional accountant review the assurance and non-assurance work as appropriate
905.5 A2	Having an additional professional accountant who was not an assurance team member review the work or otherwise advise as necessary
905.6 A2	Have an additional professional accountant who did not take part in the assurance engagement review the work performed
905.10 A2	Having a professional accountant review the assurance work or otherwise advise as necessary
907.4 A2	..... is having a professional review the work performed.
911.6 A2	Having the work reviewed by a professional who is not a member of the assurance team or involved with the assurance engagement
922.5 A3	..... conducting a review of the work performed by the individual as an assurance team member.

Similarly, various phrases are used throughout the Code on the principle of confidentiality, such as:

- “When seeking guidance of third parties, the principle of confidentiality applies” [210.9 A1]
- “While being alert to the principle of confidentiality” [R220.12]
- “The principle of confidentiality applies in communication with external parties” [270.4 A4]

We believe that such statements could be further standardized to ease the reading of the Code and facilitate translations.

We note that Section 906 only contains a requirement, but no application material is provided. On the other hand, Section 907 does not contain any requirements, but there is application material. Although, the introductory paragraph mentions the application of the conceptual framework, a more consistent approach would make the Code easier to follow.

### **Delineation of Requirements and Application Material**

As highlighted in our [response](#) to Safeguards – ED 2, there are numerous instances where the draft application materials appear to contain a requirement. We believe that clarification is therefore needed in the following places:

- The wording of 210.8 A1 might imply a hidden requirement because it states “It is generally necessary ...”, As such, the authority attaching to this application material is not sufficiently clear.



IESBA should clarify the authority (i.e., can a safeguard be deemed effective or ineffective if full disclosure is not made to, and consent obtained from, the relevant parties in one of the various ways as outlined in 210.8 A2?).

- 220.7 A1 states that a requirement “... includes...” which implies the list of inclusions are themselves requirements and so may not be appropriately placed as application material. In this context, 220.10 refers to fulfilling such responsibilities. It is unclear whether this terminology is intended to imply a requirement or otherwise. Consistent terminology would be helpful. As pointed out in our letter to the Board during the Structure Phase I project, it is vital that the Code should be clear that examples are not extensions of any requirements and if following a particular example is required, it should not then be included in the application material.
- 220.10 A1 is currently drafted as “factors to consider in determining ....” which implies that these factors will always have to be considered and, therefore may unintentionally constitute a requirement. A better way to draft this could be “factors that might be considered .....”
- 260.7 A1 uses the construct “when responding to ....., the objectives of the professional accountants are ....” . This implies required behavior and mirrors the requirements in this section. Furthermore, the authority of such material that purport to explain a broad objective (or an ideal state) is unclear.
- The second sentence of 200.9 A1 states “In these cases, if matters are communicated with person(s) with management responsibilities, and those persons also have governance responsibilities, the matters do not need to be communicated again with those same persons in their governance role.” This is a clarification of a requirement that in itself constitutes a negative requirement. There are similar negative requirements clearly shown as requirements elsewhere in the restructured Code (see R800.7 and R800.8). We suggest this text be moved and placed within a requirements paragraph.
- 240.4 A3 requires the professional accountant to evaluate the nature of the financial interest. This is a requirement and should not be embedded in an application material.
- Use of the present tense in application material should be avoided, as its use makes the authority of such text unclear. There is considerable inconsistency in the drafting of application material. Use of the present tense such as “Matters to consider include ...” (see 220.10 A1, 260.16 A1, 360.11 A2, 360.19 A1, 360.30A2, 360.34 A1, 360.36 A3 etc.) implies a non-exhaustive list of matters which are to be considered in all cases (i.e., implies a requirement). In other instances, the proposed text reads “the professional accountant might consider ...”, which is clearer.



### **Inconsequential Matters**

Proposed Part 2 includes a reference to clearly inconsequential matters in para 260.7 A3, and is therefore limited to the NOCLAR section. This important clarification ought not to be limited to the section on NOCLAR alone, but be extended to all circumstances giving rise to potential threats covered by the Code, since a clearly inconsequential matter can per se not be deemed to threaten compliance with a fundamental principle anywhere in the Code.

In our view, the prominence of this material should be reconsidered. The fact that a professional accountant is not required to comply with the Code in regard to clearly inconsequential matters limits the applicability of requirements within the Code, and should be much clearer and significantly more prominent. As it impacts (i.e., limits) the overall requirement for professional accountants to identify, evaluate and address threats, its applicability to the Code's requirements needs to be clear.

### **Use of the Terms “Expectations” and “Encouraged To”**

We note several instances where application material refers to “expectations” of professional accountants. Notwithstanding the placement of such text in application material, the use of such terminology does mean that the authority of this text may be less clear than is desirable in the restructured Code.

For example, the second sentence of proposed 200.5 A3 implies that any professional accountant in a suitably senior position in an organization ought to live up to the expectation and thus encourage and promote an ethics-based culture. The extent of such an implicit requirement remains unclear. Further examples include: 260.12 A1, 260.24 A1, 360.10 A2, 360.29 A1 and 905.6 A1.

We also note instances where “professional accountants are encouraged to ...” (210.8 A3, 210.9 A1, 220.13 A2, 270.5 A1, 260.23 A1, 260.27 A1 and 360.40 A1). In many cases, encouragement is in relation to documentation. Throughout the ED, there are others cases where documentation is not mentioned (e.g. relating to independence), and yet others where specific documentation appears to be required. Whilst it is clear that encouragement is not intended to equate to a requirement, we are concerned that where such guidance is specifically provided in the Code, this could be perceived as representing best practice and thus represent a de facto requirement. We suspect that regulators will eventually pick this up as such. At the least, some reference to the exercise of professional judgement, or to when such encouraged action might, or might not be, particularly appropriate would be helpful in the Code.

### **Communication with Those Charged With Governance**

Both R200.8 and R200.9 together with the accompanying application material deal with communication with those charged with governance. Such communication appears only relevant to the extent that it may constitute a safeguard measure in certain circumstances. This aspect is not clear from its placement in the Code and a brief explanation to this end would be helpful.



### **Applicability of Part C to PAPPs**

Reading the ED, it is clear that Section 200 is not designed for professional accountants in public practice as many of the examples are simply not relevant to their circumstances (e.g., 220.4.A1, as in this case independence requirements preclude an auditor from being involved in preparation and presentation of financial statements subject to audit). We would like to request the Board to consider using sign-posts within the Code to direct PAPPs to only three specific areas (i.e. conflicts of interest, pressure and inducements) and not the entire Section 200 as this otherwise introduces burdens to individual practitioners, which are likely to be disproportionate. It is not accurate for the Board to state in the “Applicability” ED that this will not entail disproportionate cost to the SMP community when reading the entire Part 2 of the Code.

### **Unclear Wording and Related Translation Issues**

The term “to consider” is often subject to various interpretations in English, but also causes difficulties on translation. For this reason, standard setters such as the IAASB have chosen to avoid using this term where possible. We note that there are many requirements for the professional accountant to consider certain courses of action (e.g., R220.9, R220.12, R260.9, R360.14, R360.17, R360.26 etc.). There are even more instances of its use in application material. Wherever possible, an alternative term would be preferable, so that it is clear exactly what the requirement is intended to entail.

We believe that Para 360.28 A1 seems to be missing some text. It should be made clear that where the Code’s NOCLAR provisions extend beyond matters identified in an audit according to ISAs, additional documentation of such matters is also required.

### **Other Suggestions**

We have number of editing suggestions for the attention of the task force:

- R923.5 puts a requirement on the management of the assurance client to make all relevant decisions. Instead, the Code should be drafted in a way that the partner or employee of the firm should avoid assuming management responsibility, to be consistent with other parts of the Code (e.g. Para R600.8).
- R924.6 A2 includes “...removing the individual from the assurance engagement.”. We believe that “provided that the fact is known” should be added to cover if a staff had entered into an employment negotiations without the firm’s knowledge.
- R910.10 contains “... an inheritance, gift, as a result of a merger, or in similar circumstances”. We recommend that ‘other’ should be added – “...in or in other similar circumstances”.
- In Para 240.2 we suggest adding the word ‘threat after self interest in the second sentence - “Self-interest threat to compliance with the principles....”.
- Under Para 905.4 A2, an example of safeguards includes “consulting with a third party such as a professional body or a professional accountant on key assurance judgments and taking appropriate steps following the consultation”. This wording “and taking appropriate steps following the consultation” denotes an active follow through action and this drafting convention should be applied consistently to all paragraphs where consulting a third party is mentioned.



## **Conforming Amendments Arising from the Safeguards Project**

*3. Respondents are asked for any comments on the conforming amendments arising from the Safeguards project. Comments on those conforming amendments are requested by April 25, 2017 as part of a response to Safeguards ED-2.*

We submitted our comment letter to the Safeguards Phase 2 ED last month. However, we would like to take this opportunity to reiterate that in a number of the proposed safeguards, having another independent professional perform the service or review the work that was performed may be difficult to implement in most SMP environments. Likewise with the proposed notions of restructuring or segregation of duties.

*4. Do you agree with the proposed effective date for the restructured Code? If not, please explain why not.*

We have previously highlighted concerns that many SMPs have been struggling with limited resources and constant changes in rules and regulations over a long period of time. The [2016 IFAC Global SMP Survey](#) found that keeping up new regulations and standards was the second highest global challenge and the regulatory environment was the top anticipated factor to impact practices in the next five years.

We are therefore concerned that the proposed effective date may not provide SMPs with sufficient time to be able to review the new code, understand the implications, formulate policy changes at the firm level, as well as influence staff behavior. In addition, there will be significant challenges for IFAC member organizations' translators. Thus, the Board should seriously consider a minimum time frame of 24 months instead.

We are also concerned that the Board is encouraging member organizations to start the translation process in the Explanatory Memorandum – using the staff-prepared compilation of the restructured Code. This may not be efficient as the changes are not finalized and could be interpreted that the Board has already taken certain positions and this ED is merely a “tick the box” formality.

## **CONCLUDING COMMENTS**

We hope the IESBA finds this letter helpful in moving towards the finalization of the Re-structured Code. In turn, we are committed to helping the Board in whatever way we can to build upon the results of this ED (as well as the other two).

Please do not hesitate to contact me should you wish to discuss matters raised in this submission.

Sincerely,

A handwritten signature in blue ink that reads "Monica Foerster".

Monica Foerster