Ken Siong
IESBA Technical Director
IFAC
529 Fifth Avenue
6th Floor
New York
NY 10017
USA

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Dear Mr Siong

Consultation Paper – Improving the Structure of the Code of Ethics for Professional Accountants

The Financial Reporting Council (FRC) welcomes the opportunity to comment on the matters raised in the above Consultation Paper concerning how the structure of the Code of Ethics for Professional Accountants (the Code) could be improved.

We are supportive of IESBA undertaking a project to improve the structure of the Code. We have raised concerns with IESBA in the past concerning the structure and language of the Code, including the lack of a clear distinction between requirements and guidance, and are pleased that issues related to these concerns are identified in the Consultation Paper. However, we are concerned that the project appears to be primarily focussed on clarifying the Code using a similar model to that adopted by the IAASB when it clarified the ISAs. We understand why, when the ISAs were clarified over five years ago, consideration was given to clarifying the IESBA Code using a similar approach. But time has moved on and we believe that current concerns about professional accountants’ ethics may not necessarily be best addressed by a move to an ISA type model (with a ‘purpose’ in place of the ISA objectives and then ‘requirements’ followed by ‘application and other explanatory material’ as illustrated in the consultation paper).

ISAs establish standards that are focussed on ensuring auditors obtain sufficient appropriate audit evidence and exercise professional scepticism. Accordingly, many of the requirements are process based. Ethics, however, is not about process but rather about good behaviours, driven by high personal values/morals and a mind-set focussed on serving the public interest.

The project to restructure and clarify the Code will be a major exercise. In addition to improving clarity, it provides an opportunity to address some stakeholder concerns about ethics that may at least in part be related to the current structure. In particular, it should provide an opportunity to support a realignment of auditor attitudes to ethics with the values expected by stakeholders. It should not be seen just as a means of better expressing the current position, which risks reinforcing perceived issues.

In our experience, some professional accountants’ attitudes towards ethics appear to be driven by a rules based mind-set. This can lead to ethical issues being evaluated on the basis of “is this specifically prohibited” rather than “is this appropriate”. This in turn may undermine the principles based ‘threats and safeguards’ approach and may result in the
auditor pursuing activities or relationships that reasonable and informed third parties would perceive as likely to compromise ethical principles.

In the consultation paper, IESBA identifies that it is “mindful of the importance of the conceptual framework approach which addresses threats to compliance with the fundamental principles rather than simply complying with rules” and that “any changes to the structure of the Code should retain the conceptual framework approach”. However, we believe that restructuring the Code using an ISA model, which emphasises hard requirements, may further encourage a rules based mind-set with an undue focus on the requirements rather than on the fundamental principles. In the 2014 edition of the Code, there are approximately 400 occurrences of the term “shall” and this highly granular approach in our view encourages a rules–based mind-set. This would be further exacerbated if each such occurrence were to be presented as a separate requirement in an ISA style format in the revised Code. We appreciate that a principles based approach can be aided by supporting requirements/provisions, but it is important that the principles established in the Code clearly have primacy and should provide for decisions relating to circumstances that may not have been foreseen and are not covered by specific requirements/examples.

The perceptions of reasonable and informed third parties are a fundamental consideration. Trust in the work of professional accountants requires them not only to act ethically but to be perceived to be acting ethically. Certain actions, even though they may not in given circumstances compromise a professional accountants’ ethical mind-set may be perceived to do so and, thereby, occasion a loss of trust.

Accordingly, when improving the structure of the Code, we strongly recommend that IESBA considers how the Code can be improved to seek to ensure that professional accountants have the right ethical ‘mind-set’ and we urge IESBA to prioritise clarifying and emphasising the fundamental ethical principles. It is particularly important that, in each of the sections that address threats to compliance with the principles, it is clear what the relevant principles are and that the overarching objective of the professional accountant should be to comply with those principles. The illustrative ‘purpose’ sections of the examples presented in the consultation paper (which take the place of the ‘objectives’ in the ISAs) do not achieve this.

We recommend that, before proceeding further with this project, IESBA undertakes further research to identify and understand the structure and presentation of ethical codes issued by other bodies. This could give useful insight into other possible models and enable evaluation of what would best achieve the primary objectives, which in our view should include helping drive compliance with the ethical principles with a principles based mind-set rather than a rules based mind-set. This research should not be restricted to ethical codes for professional accountants but also consider other professions where ethical codes are important such as the legal and medical professions.

We comment below on other specific matters highlighted in the consultation paper

**Distinguishing requirements from guidance**

We agree that it is necessary to distinguish ‘requirements’ more clearly from the guidance as the current form of presentation is very unhelpful. However, as we indicate above, the primary focus should be on emphasising the principles. It needs to be clear that the requirements are intended to help support compliance with the principles, but complying with the requirements should not be taken to mean necessarily that the principles have been complied with by default – accountants need to evaluate circumstances with a principles based mind-set not a simple requirements/rules based mindset. In making these evaluations
the key consideration should be whether a reasonable and informed third party would perceive that the ethical principles have been complied with. It should be clearly established that if there is doubt about the ethical propriety of a certain activity or relationship it should not be entered into.

The primacy of the principles may also be emphasised by presenting the requirements as ‘supporting provisions’ rather than ‘requirements’.

Reorganisation of the Code
We do not find it overly difficult to navigate around the Code. Nonetheless, we appreciate that IESBA has identified that some stakeholders do find navigation difficult and we would support reorganisation that makes navigation easier for those stakeholders and distinguishes, where relevant, considerations that may, for example, be specific to accountants in business and to external auditors.

However, as identified above, we believe the focus should be on the ethical principles and it is essential that any reorganisation supports that. We are concerned that the approach contemplated in the consultation paper does not achieve that and puts too much focus on the ‘requirements’.

It is also important that any reorganisation helps ensure that professional accountants are aware of all the principles and supporting provisions that are relevant to them.

Use of language
We support the objective to enhance the readability and clarity of the Code and to consider how the use of language could be improved. However, we do not agree that it is appropriate for the term “audit” to be deemed to include “review engagement” for the purpose of particular sections where considerations are essentially the same (e.g. in relation to independence). This could be resolved otherwise by creating a duplicative new section only for review engagements; for example, by establishing upfront that the material in the common section is relevant to both audit and review engagements unless stated otherwise and then just using the term “engagement” rather than “audit”.

Identification of a firm’s or individual professional accountant’s responsibility
In order to achieve consistent application of the supporting requirements/provisions within the Code it is essential to be clear to whom they each apply.

We agree with IESBA’s view that a global code should be sufficiently flexible to accommodate different circumstances that firms need to take into account when prescribing the specific responsibility of individuals within the firm for actions related to independence. However, in our view, for audit firms the senior management of the firm, regardless of its size, should have the overarching responsibility to ensure an appropriate ethical mind-set and culture within the firm. Without the right ‘tone at the top’ it is unlikely that the firm as a whole will have an appropriate culture. This is a particularly important consideration in multi-disciplinary firms and especially where audit and other public interest assurance services may be a minority function and/or the senior management are not part of the audit function.

This may be achieved by requiring senior management of the firm, and those with direct responsibility for the management of the firm’s audit and other public interest assurance business, to instil the necessary culture and behaviours throughout the firm so as to ensure that compliance with the ethical principles is paramount and supersedes all commercial interests of the firm. This should include: establishing appropriate policies, procedures and quality control and monitoring systems; dedicating appropriate resources and leadership to
compliance with this supporting provision; and making appropriate arrangements with network firms to ensure compliance as necessary across the network. We believe that this approach provides flexibility for firms to determine how best to implement these provisions in their circumstances.

**Other comments**

We support IESBA’s separate proposal for a project to review the clarity, appropriateness and effectiveness of the safeguards identified in sections of the Code. We believe that project should be undertaken at the same time as the project to improve the structure of the Code. Both projects are key to ensuring an appropriate focus on the ethical principles and improving the clarity of the Code to facilitate its effective implementation and consistent application. If these two projects are not run concurrently, there is a significant risk of a need for a further major revision of the Code within a relatively short period of time.

While we appreciate that the Code is designed to apply globally, we strongly recommend that IESBA takes into consideration the ethical provisions in the EU Audit Directive and Regulation and ensures that the Code is compatible with them.

We are aware that at least one other jurisdiction (the Netherlands) has recently clarified and improved its Ethical Code. We are also in the process of reviewing our own ethical standards for auditors with a view to considering how they may be clarified and improved. Our review will address the issues we have identified above where applicable (in particular to improve emphasis on the principles) as well as implementing the ethical provisions in the EU Audit Directive and Regulation. We intend to issue exposure drafts of revised standards later this year and will keep IESBA informed of our developments. We are supportive of IESBA’s aspiration for international harmonisation of ethical standards for accountants, and we aim to ensure that compliance with our standards results in compliance with the corresponding sections of the IESBA Code. We encourage IESBA to continue to seek to develop the Code in a way that increases its adoption globally.

Yours sincerely

Nick Land
Director of the FRC and Chairman of the FRC’s Audit & Assurance Council

*Enquiries in relation to this letter should be directed to Marek Grabowski, Director of Audit Policy.*
*DDI: 020 7492 2325*
*Email: m.grabowski@frc.org.uk*
About the FRC

The Financial Reporting Council is the UK’s independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. We promote high standards of corporate governance through the UK Corporate Governance Code. We set standards for corporate reporting and actuarial practice and monitor and enforce accounting and auditing standards. We also oversee the regulatory activities of the actuarial profession and the professional accountancy bodies and operate independent disciplinary arrangements for public interest cases involving accountants and actuaries.