

April 18, 2016

## **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 1***

### **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 18 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's meetings and previously submitted a comment letter in response to the November 2014 [Consultation Paper](#).

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).

We welcome the reference in the ED to the results from the [SMP Quick Poll](#), which indicated that the biggest barrier faced by SMPs in fully adhering to the Code was due to understanding its requirements. In previous comment letters we have repeatedly strongly encouraged the IESBA to consider using less conventional ways of eliciting feedback and comments on its restructuring proposals so as to obtain input from the largest possible number of SMPs. 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 note, unfortunately, from the April 2015 IESBA Board papers (Agenda Item 5-A) that the Consultation Paper did not elicit responses from SMPs in the 'firm' category and only two responses from 'Individuals and Others'. Despite this, SMPs are one of the main user groups of the Code and therefore it is important their opinions are obtained and their input considered by the Board.

Following the Consultation Paper we prepared a discussion on the Global Knowledge Gateway '[An SMP Perspective on Improving the Structure of the IESBA Code of Ethics for Professional Accountants](#)', which



was also promoted on various social media channels. We look forward to seeing how the IESBA has increased the number of SMP responses and engaged with this important constituency.

## **SPECIFIC COMMENTS**

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

*1. Do you agree with the proposals, or do you have any suggestions for further improvement to the material in the ED, particularly with regard to:*

*(a) Understandability, including the usefulness of the Guide to the Code?*

In principle we agree that the outlined approach to restructuring would be likely to achieve the Board's objective of making the Code more understandable.

We consider that some information in the new Guide to the Code may be useful to practitioners. However, it is not clear how the Guide to the Code interacts with some elements of 'Part A Introduction to the Code and Fundamental Principles' as this also contains general information. We also question the inclusion of a "Guide" as part of the Code itself, as the status of it is unclear and may cause confusion. For example, we do not consider that a guide should include requirements (for instance, paragraphs 10 - 12) and believe these should be moved to Part A and clearly identified.

The inclusion of paragraph 13 under 'Additional Non-Authoritative Guidance' may also create uncertainty as to the authority of material beyond the Code. Whilst the information may be useful, we do not believe such references should be made in the Code itself and recommend this paragraph is deleted.

*(b) The clarity of the relationship between requirements and application material?*

The Committee supports the approach to distinguish requirement paragraphs with 'R' and position application material next to the relevant requirements – identified with 'A'. These changes should enhance the users understanding of specific prohibitions. We support the proposed approach of requirements being denoted by the word "shall", which is not used in the application material component.

The Explanatory Memorandum states that the application material component includes examples of procedures, including safeguards that may be appropriate in the context of the engagement or assignment. There is also a new paragraph in the Guide to the Code (para. 9), which states that where the application material includes lists of examples "these lists are not intended to be read as exhaustive lists of all possibilities or circumstances that might arise". We suggest the Board consider highlighting that professional accountants are required to exercise professional judgment in complying with the relevant requirement. It is vital that the Code is clear that the examples are not extensions of the requirements and if following a particular example is required, it would not be included in the application material.

It is important that there is a clear distinction between those instances where judgment may be based on the factors in the application material and those instances where the factors would always need to be taken into account, since the latter constitutes a requirement. For example:



- The second sentence of 310.11 A1 states “factors to consider...”, which is not clear whether the factors must be considered, and if so all of them.
- Paragraphs 310.11 A2 states “...it is generally necessary...”, which could add confusion given that the requirement is to use professional judgment (see above).
- Paragraph 114.1 A1 seems to be worded more in the nature of a requirement than application material.

The IESBA needs to be very clear on these instances, otherwise the Code may not be consistently applied. In addition, the IESBA uses “might consider” in two instances (300.3 A1 and 404.2 A2) and “may consider” once (350.5 A1). It may help the user and translators to be consistent on these and we note that the ISA application material consistently uses “may consider”.

*(c) The clarity of the principles basis of the Code supported by specific requirements?*

In our opinion, the Code should prioritize attainment of ethical behavior through application of principles rather than prescription. The IESBA must ensure that there is an appropriate balance between requirements and application material and the focus is on addressing the threats to compliance with the fundamental principles through the conceptual framework approach, rather than with rules. This is also important to allow the Code to work in conjunction with various national requirements.

As outlined in [our response](#) to the recent IESBA Exposure Draft: *Proposed Revisions Pertaining to Safeguards—Phase 1*, we believe that the new overarching requirements for all Professional Accountants (PAs) to apply the Conceptual Framework at the beginning of each Section should be replaced with overarching objectives for the PA, which are supported by more specific requirements. This would serve in combination with the requirement for PAs to make an overall assessment of whether or not the objective has been met (similar to R120.9), supported by the explicit requirements and application material. In our opinion, the broad requirements such as those in R120.3 and R300.2 can be difficult in practice (including monitoring compliance etc.). Using more general objectives means the requirements can be more specific and the expected actions are far clearer.

We consider that the inclusion of the header ‘The Conceptual Framework contained in Section 120 applies in all circumstances’ on each page is unnecessary and unlikely to have an impact on ethical behavior.

In addition, we believe that paragraphs 10 and 11 under exceptional circumstances in the *Guide to the Code* are not in the right place for such an important issue and may be open to misuse. The Board may wish to consider how the IAASB addresses these issues in ISA 200<sup>1</sup>, paragraphs 21, 23 and 24.

*(d) The clarity of the responsibility of individual accountants and firms for compliance with requirements of the Code in particular circumstances?*

We support the Board’s decision to defer further consideration of the matter of responsibility until the IAASB has analyzed stakeholders’ input to its consultation on ISQC 1 included in the Invitation to Comment, *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and*

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<sup>1</sup> International Standard on Auditing (ISA) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*



*Group Audits.* We strongly support the IESBA working together with the IAASB when considering the issue of responsibility.

In our view, the IESBA should adopt the “think small first” principle in its approach. This is important to ensure the end product is useable by the full range of firms – from sole practitioners to practices with many partners. The key issue is that the particular ethical requirement is adhered to, not who is and who is not, assigned the responsibility.

Footnote 11 states that “In Part A, “professional accountant” includes “professional accountants in business” and “professional accountants in public practice”, which also includes their firms”. There is text in Part A which may need to be reviewed to clarify the responsibilities of both individual accountants and firms. For example, paragraph R120.9 states that “the professional accountant shall review judgments made...”. There is a risk that an individual may therefore blame all the professionals in the firm for not having done so, no matter of their responsibility level.

*(e) The clarity of language?*

We believe that the work undertaken to increase the clarity of the language will help the understandability of the Code, in particular the simpler and shorter sentences and increased use of the active voice. The length and complexity of some of the sentences in the Code has caused difficulties for some SMPs and makes comprehension and translation difficult.

It may be understood from paragraph R100.3 that in certain circumstances some provisions are not applicable when laws or regulations preclude an accountant from complying with certain requirements. However, we believe this could be made clearer.

*(f) The navigability of the Code, including:*

*(i) Numbering and layout of the sections;*

We have no issues with the proposed numbering, which we believe should be kept simple. We also agree that reversing the order of extant Part B and Part C is logical. The use of bold text for the requirement number should also further distinguish the requirements from the application material.

Cross-referencing the requirements to the related application guidance as proposed is also essential to mitigate the risk that some users could be drawn more to the requirements, without the benefit of the separate application material and guidance and therefore have a quite different interpretation from what is intended.

*(ii) Suggestions for future electronic enhancements;*

We understand that in the majority of jurisdictions SMPs use a local translation of the Code, which has been tailored to their national jurisdiction. The Code on the IESBA website may therefore not be the prime source used by practitioners. In addition, some accountants may not have the means to use an electronic Code yet, so a paper based Code is still needed. Nevertheless, we believe that the revised structure of the



Code would aid further electronic enhancements to assist in navigability. In particular, we support the terms in the Glossary being electronically linked to the body of the Code.

*(iii) Suggestions for future tools?*

We have previously commented that we disagree with IESBA that there is appropriate separation of requirements applicable to public interest entities (PIEs) from those applicable to other entities, especially in respect to auditor independence. We believe that the Board should give this matter further consideration and highlight provisions relevant only to PIEs, which may be considered as one of the tools to assist users of the Code. Since not all SMPs have PIEs amongst their clients, this differentiation would be helpful both to those who are unaffected by more precise or more stringent requirements, as well as those who may take on new clients that are PIEs. We believe that many professional accountants in private practice throughout the world would find a clear overview of these differences helpful.

In our response to the Safeguards ED we noted that as part of its future work, the Board plans to consider whether additional guidance is needed in the Code to explain the differences in the evaluation of whether a threat is at an acceptable level for a PIE and an entity that is not a PIE. We believe that this warrants a higher priority by the Board.

*(g) The enforceability of the Code?*

We expect that clarifying ethical requirements and providing guidance material thereto would improve both professional accountants' understanding of the actions ethical behavior in accordance with the Code demands on their part, and that of those responsible for enforceability.

*2. Do you believe the restructuring will enhance the adoption of the Code?*

Restructuring the Code should enhance its understandability and usability, as well as facilitate more effective implementation.

In jurisdictions where it is solely a matter for the professional accountancy organization to adopt and supervise its member's adherence to the Code, the adoption should be fairly straightforward. In principle, this is managed through IFAC's Statements of Membership Obligations (SMOs), which are the basis of IFAC Member Body Compliance Program. In essence, SMO 4 requires the adoption and implementation of ethical standards no less stringent than the Code. We are not convinced that the restructuring of the Code will enhance its further adoption. There are many other factors impacting adoption into law and regulation, which will be taken into account by legislators in their individual decisions whether to reflect specific provisions of the Code in their national laws.

*3. Do you believe that the restructuring has changed the meaning of the Code with respect to any particular provisions? If so, please explain why and suggest alternative wording.*

It is important that the restructuring project does not change the meaning of the Code. The Committee supports the approach outlined in the Explanatory Memorandum where IESBA has noted the matters



identified that would involve potential changes outside the scope of the project for further consideration when it develops its next strategy and work plan.

We believe there are a few instances where the Board has added new or deleted existing text that may change the existing obligations and as such fall outside the scope of the restructuring project. For example, the addition of “based on current developments in practice, legislation and techniques” to requirement 113.1 may change the obligation and deleting “This includes actions that a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at that time” from R115.1 could have practical implications for understanding the extant requirements. We note there is a revised explanation of the reasonable and informed third party in 120.4 A1, but believe the IESBA should give this further consideration which may include adding cross-references.

In paragraph 112.3 A2 it is indicated that C1 and C2 set out independence requirements and application material for professional accountants in practice, but it is now not clear the content only relates to audit, review and other assurance engagements.

The diagram covering the ‘Parts of the Code’ includes the title ‘International Independence Standards’, which we do not believe is appropriate. There are some requirements related to independence affecting accountants in public practice (i.e. those not undertaking audit, review or other assurance engagements), which are not included in C1 and C2. For example, paragraph 340.2 related to gifts and hospitality.

The diagram may also benefit from highlighting that Part B Professional Accountants in Business includes those in commerce, as well as those in the public sector, education, the not-for-profit sector etc.

We will continue to review the changes once the restructured code is available in its entirety.

*4. Do you have any comments on the clarity and appropriateness of the term “audit” continuing to include “review” for the purposes of the independence standards?*

It is anticipated that review engagements may be a growing source of revenue for SMPs due to the rise, or introduction of, audit thresholds meaning that increasing numbers of small- and medium-sized entities (SMEs) no longer require an audit.

Overall we support the approach for the term “audit” continuing to include “review” for the purposes of the independence standards. We recognize that it may not be ideal, but the alternative of specifying both terms each time would increase the length of the Code with limited benefits as the requirement to be independent applies equally to an audit and review engagement. We also do not believe that there should be a separate section in the Code for review engagements.

Footnotes 14-17 highlight that “audit engagement”, “audit team”, “audit client”, “audit report” also includes “review engagement”, “review team”, “review client” and “review report”. However, one of the objectives of the restructuring is to increase the visibility of the Codes requirements and therefore we do not consider these footnotes to be sufficient. Our preference is to retain the extant description (290.3) as part of the introduction.



*5. Do you have any comments on the clarity and appropriateness of the restructured material in the way that it distinguishes firms and network firms?*

We agree with proposed restructuring to remove the dual meaning of “firm” in the independence provisions and distinguish network firms from firms.

This is a very important matter for SMPs as many can have some kind of “cooperation” structure and relationships at local, national or international levels. The Committee is aware that some organizations may try to avoid qualifying as a network firm to avoid certain responsibility matters (even if they are happy to observe most of the requirements of the Code) and prefer terms such as alliances, associations or similar. In practice differences between some organizations self-defined as networks and others that qualify themselves in different ways are not always very clear when analyzing their real structure and performance. For example, even the less formal organizations have in common some training (or regular conferences) and some kind of quality control, to be sure that when referring someone, quality is appropriate. The use of common brands, disclosure terms etc. can also be very similar in networks and associations and it is clear that an association can be a network even if it calls itself otherwise.

As the borders between associations and networks are increasingly diffusing, the Board may wish to consider any potential implications for the Code going forward.

*6. Is the proposed title for the restructured Code appropriate?*

The Committee continues to not support the proposed new title for the Code as the “International Code of Ethics Standards for Professional Accountants”. We recognize that IESBA is a standard setting board and that there are clear requirements included in the Code, in particular with independence. Nevertheless, we believe that the title could detract from the principles-based nature of the Code and there is a risk it will be seen as a move towards a more rules-based approach. Our preference would be to retain the extant title.

*Request for General Comments*

*(a) Small and Medium Practices (SMPs) – The IESBA invites comments regarding the impact of the proposed changes for SMPs.*

We believe that the needs of the SMP community should be at the forefront as IESBA takes this project forward in Phase 2. The IESBA needs to engage more with this important constituency as it prepares the next Exposure Draft in order to ensure their views are taken into consideration.



## CONCLUDING COMMENTS

We hope the IESBA finds this letter helpful in moving forward with the project to restructure the Code. In turn, we are committed to helping the Board in whatever way we can to build upon the results of this Exposure Draft. Please do not hesitate to contact me should you wish to discuss matters raised in this submission.

Sincerely,

A handwritten signature in black ink, appearing to read 'Giancarlo Attolini', written over a horizontal line.

Giancarlo Attolini  
Chair, SMP Committee