

18 April 2016

Mr. Ken Siong
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International Ethics Standards Board
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submitted electronically through the IESBA website

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Re.: Exposure Draft, Improving the Structure of the Code of Ethics for Professional Accountants - Phase 1

Dear Mr. Siong,

The IDW appreciates the opportunity to comment on the above mentioned Exposure Draft and proposed changes to the Code of Ethics for Professional Accountants hereinafter referred to as “the ED” and “the Code”, respectively. We submit our comments as follows:

General Support

We continue to support the proposed restructuring of the Code.

We agree with the way the IESBA has set about this project as described in paragraphs 5 and 6 of the Explanatory Memorandum. In particular, we consider it essential that changes to wording made in this project do not change the meaning of the Code, and that matters involving potential changes in meaning are identified and noted for further discussion by the IESBA within the Board's established due process. In this context, we refer to our comments on specific proposed wording changes in the appendix to this letter.

We also agree that the proposed structure is an improvement on the extant structure. We nevertheless believe that ease of navigation could be improved further with changes to some subsections, including the use of objectives as well as some additional cross referencing.

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Klaus-Peter Feld, WP StB;
Dr. Daniela Kelm, RA LL.M.

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Consistency in Application

Specifically, we agree with the IESBA that enhancing the understandability and usability of the Code is necessary to facilitate its adoption, effective implementation, consistent application and enforcement.

In this context, we continue to have concerns as to the potential for differences in understanding or appreciation of certain terminology used in the Code in different jurisdictions. To the extent that the understanding of a particular term or terms is key to the application of requirements of the Code, (a) definition/(s) is/(are) needed. In this context, we refer to specific comments we have made in the appendix to this letter.

Application of a Threats and Safeguards Approach

As paragraph 13 of the Explanatory Memorandum recognizes, the Code's established threats and safeguards approach is highly significant to an appropriate application of the Code.

We believe it would be helpful to place a paragraph in the introduction to provide a brief explanation of how the professional accountant is expected to apply the threats and safeguards approach in following the IESBA Code. Ultimately, linking the threats and safeguards identified within the Code to each of the relevant fundamental principle(s) would also improve readers' understanding of how this approach is intended to assist professional accountants to comply with the fundamental principles.

The ED currently lacks consistency in this regard, with Para 112.2A2 listing examples of safeguards ahead of the concept of a threats-and-safeguards approach having been explained (R120.7). Similarly it would be helpful to identify the threats included in each of the subsections 111-115 as such, instead of them merely being worded as part of a requirement, as currently drafted.

Objectives to Support Requirements

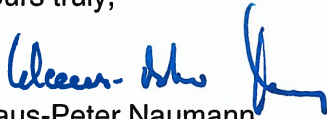
In our view the use of objectives would fit in well with the threats and safeguards approach which, although supplemented by specific requirements in part, also requires professional judgment as to whether additional measures are to be taken, when a threat has been reduced to an acceptable level, and how to deal with exceptional circumstances etc. In this context, we are interested to note from the Safeguards Project the Board's belief that the fundamental principles establish overarching objectives professional accountants are required to meet (Para 9(a)(i) Explanatory Memorandum to ED: Proposed Revisions Pertaining to Safeguards in the Code - Phase 1).

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In the appendix to this letter, we propose that rather than being worded as requirements, the first paragraph in each of the subsections 111-115 might be rephrased as an objective, and subsequently supplemented by text explaining where the Code has identified threats. Establishing for all professional accountants an overall objective for each fundamental principle would provide a basis for individual accountants to “step back” and consider whether – in adhering to each of the individual requirements relevant to the particular circumstances – they have achieved the objectives, or whether further safeguards are called for, as appropriate.

We trust that our comments will be received in the constructive manner in which they are intended. If you have any questions relating to our comments in this letter, we should be pleased to discuss matters further with you.

Yours truly,



Klaus-Peter Naumann
Chief Executive Officer



Helmut Klaas
Director European Affairs

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Appendix

Request for Specific Comments

Refinements to the Code

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?*

We have identified the following issues in regard to the section entitled “Guide to the Code”:

- In our opinion, the content of this section is overly diverse. Much of the material is introductory in nature and could be placed in an introductory section. We believe that certain other material (paragraph 6, 10-12) ought to be revised so as to clarify the Code’s requirements and be relocated.
- Using the term “Guide to the Code” as a part of the Code itself may lead to some confusion, especially as the material does not constitute a Guide in the general sense of the term. For example, the IFAC SMPC has produced various Guides (incl. ISA, Reviews, Compilations, and Quality Control etc.) predominantly for SMP constituents. References to supplementary non-authoritative guidance (paragraph 13) should not form part of the Code.
- The description of the relationship between independence and objectivity as proposed in paragraph 3 is somewhat awkward and unclear. We suggest this be reworded in terms of independence being a key factor in facilitating (or enabling) objectivity in certain circumstances. Indeed, the relationship of the independence standards to the rest of the Code needs to be explained, as the nature of these standards differs from that of the rest of the Code. It needs to be clear that the professional accountant’s use of professional judgment differs considerably when applying the framework to judgment used in following (set) requirements in such standards. The latter may lead to an individual or firm being sufficiently independent, but this of itself does not “guarantee” compliance with the fundamental principles.

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- Whilst the sentence at the bottom of the second bullet of paragraph 4: “Professional accountants in public practice might also find Part B relevant to their particular circumstances” is taken directly from existing text, it leaves the issue of authority unclear. It would be helpful to add a sentence to clarify that consulting Part B is not intended to impose additional requirements, but instead may be helpful in terms of guiding the behavior of professional accountants employed in public practice.
- Paragraph 6 states: “The Code requires professional accountants to comply with the fundamental principles of professional ethics.” We suggest this be reworded as an overall objective (see comments elsewhere in this letter), and placed in Section 110.
- Paragraph 13 creates considerable uncertainty as to the authority of material that does not form part of the Code. In our view such references should not be made within the Code itself. We therefore suggest this paragraph be deleted.

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

We support the proposed differentiation between requirements (denoted by the word “shall”) and application material as well as the approach taken by the IESBA in drafting application material (EM para 17), and comment further as follows:

Clarification of Authority

We are aware that concerns have arisen as a result of differing interpretations in practice concerning some application material within the ISAs. For example, a regulator’s view as to the need to perform an audit procedure provided as an example in application material may differ from that of the auditor, who may have chosen not to apply a particular procedure. It is therefore desirable that the restructured Code be as clear as possible as to the respective authorities of requirements and application material.

We note from the third bullet of paragraph 16 of the Explanatory Memorandum that application material includes examples of procedures. It is important that the Code clarify that in such circumstances such examples provide guidance and should not be interpreted as implying a de-facto authority that was not intended by the Board. Paragraph 9 of the Guide to the Code mentions that lists of examples included in application material are not intended to be exhaustive. This paragraph also ought to clarify that since professional accountants are required to exercise professional judgment in complying with the relevant

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requirement they will not necessarily draw on any or all of the examples. If following a particular example is required, it would not be included in application material.

Placement of Application Material

The proposed placement of application material as close as possible to the relevant requirements would mean the presentation of the IESBA Code differing from the standards issued by the IAASB. To the extent that the “audience” for the respective Boards’ pronouncements is the same, we wonder whether having these different approaches will be the best solution going forward.

On balance we believe that, whilst it may also have its drawbacks, a structure similar to that of the ISAs might be preferable; with requirements listed sequentially and cross referenced to the relevant paragraph(s) within separately placed application material.

Application material 112.3A1 and 112.3A2 are misplaced in the ED, as they are not relevant to the fundamental principle as applicable to all professional accountants. We suggest this be relocated as appropriate.

Use of Present Tense within Application Material

We note many instances where application material uses the present tense, which is undesirable. According to the Explanatory Memorandum the IESBA sought to avoid present tense text in order to limit ambiguity. This is an issue that will need to be reviewed before the restructuring project is concluded. We further note instances where application material has been split from a requirement paragraph, but remains in nature part of the requirement (e.g., 115.1A1 is essentially part of R115.1). We encourage the IESBA to specifically address both these issues going forward in coordinating with restructuring undertaken by other IESBA Task Forces in order to ensure consistency throughout the entire Code.

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

As mentioned in our letter, we are not convinced that the proposed approach to use only requirements to replace obligations in the extant Code is the most workable solution.

Instead of formulating single requirements in paragraph 6 of the Guide to the Code and in subsections 111 – 115, the broader obligations to adhere to the

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Code and to each of the Code's fundamental principles might be more appropriately articulated as objectives. Maintaining ethical behavior in line with the Code could constitute an overall objective to be placed in section 110. Such an overall objective supported by a set of objectives for each fundamental principle would provide the professional accountant with a basis to check back against (e.g., in circumstances where the Code is silent, or a requirement prescribed is impracticable but could be "replaced" by another course of action, where the professional accountant faces an exceptional circumstance such as described in paras. 10 and 11 of the Guide to the Code). If the Board were to redraft these proposed requirements as objectives it could then introduce a supplementary requirement for professional accountants to "step-back" and satisfy themselves that in following the Code they have indeed achieved the specific-objectives for each of the fundamental principles and the overall objective in the particular engagement or circumstance.

Such an approach would be similar to that adopted by the IAASB in ISA 200.21 and 24. In our opinion, it would also better articulate the nature of fundamental principles and an individual professional accountant's compliance thereto in the specific circumstances encountered.

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

As noted in the 2014 Consultation, a global Code should be sufficiently flexible to accommodate different circumstances that individual professional accountants and firms need to take into account when prescribing responsibilities.

The Code was originally written with individual professional accountants in mind rather than any responsibilities to be adopted by their firms or employers. We have two comments:

- It is important that the Code recognize the ability of an individual professional accountant to adhere to the Code may be affected by policy or requirements within a firm or other employing organization. Ideally any such policies would support ethical behavior. However, in the absence of such support or, conceivably, where compliance might be precluded clarification may be needed.
- We encourage the IESBA to use its restructuring project to enhance its cooperation with the IAASB in clarifying the respective responsibilities of individual professional accountants and firms. Professional accountants need clarity as to what is expected of them individually, and how such

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responsibilities tie in with their respective firms' or employers' responsibilities. To the extent that it makes sense for certain responsibilities to be assigned, the Code and the IAASB's standards should be clear.

(e) The clarity of language?

Reference is made to the term "public interest" throughout the ED in the wider context of the profession's public interest responsibilities. However, where this term is to be used in a particular context beyond this ED, either a definition or, failing that, a broader explanation of the IESBA's intent will be essential, in order to limit the potential for different parties to have varying interpretations of the meaning and impact of this term. Specifically, we believe that a lack of guidance as to the intended meaning of the term "public interest" potentially leads to inconsistency in terms of compliance with the Code. This is of particular concern where the third party test taken from paragraph 120.4A1 is augmented by a public interest element (as proposed in the NOCLAR project).

The text dealing with exceptional circumstances (paragraphs 10 and 11 of the section headed Guide to the Code – which we have suggested be relocated) is extremely important, as circumstances may arise in practice that were not foreseen by the Board in devising the Code, and by its nature a Code cannot anticipate every possible circumstance in which it is intended to apply. A professional accountant may encounter circumstances where, for a variety of different reasons, following a specific requirement "to the letter" would be inappropriate, impracticable or ineffective. Not only does the Code need to deal with this issue clearly, it also needs to be sufficiently robust as to prevent unwarranted misuse. Thus, improving the clarity of the Code in this area is a key issue. We note that although the wording proposed has been changed slightly, the term "encouraged" does not equate to a clear statement of requirement for a professional accountant. The IAASB faced a similar challenge in its clarity project, and included the following specific requirement and application material to deal with this:

ISA 200.23: "In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in an ISA. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement. (Ref: Para. A74)"

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ISA 200.A74: "ISA 230 establishes documentation requirements in those exceptional circumstances where the auditor departs from a relevant requirement.¹ The ISAs do not call for compliance with a requirement that is not relevant in the circumstances of the audit."

We would encourage the IESBA to adopt a similar approach.

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

i. Numbering and layout of the sections;

We refer to our comments above.

We also believe that, in taking this project forward, the IESBA should in some way highlight provisions that relate only to certain types of engagement or situation; specifically provisions relevant only to PIEs.

We reserve further comments until an ED showing the entire Code in restructured format is available.

ii. Suggestions for future electronic enhancements; and

We do not have further suggestions.

iii. Suggestions for future tools?

Non-authoritative material such as noted for further consideration may be useful in facilitating the Code's adoption, effective implementation, consistent application and enforcement. Experience at the IAASB has shown that staff papers etc. or publications by other parties may address such needs.

(g) *The enforceability of the Code?*

The Code needs to be as clear as possible to limit potential for differing interpretations by those applying the Code and those responsible for its enforcement. We refer to comments elsewhere in this letter in this regard.

¹ ISA 230, paragraph 12.

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

An improved structure may be helpful in comparison with the current structure, in that readers will be better able to understand what is required of professional accountants and to differentiate those situations in which specified actions are always required from those where professional accountants may be required to choose an appropriate action from a possible range of actions. This should, in turn, help resolve implementation issues and improve consistency in this regard.

Whilst restructuring may lead to improved understanding of the Code, we do not believe it will in and of itself enhance adoption of the Code, as there are many other factors that will impact adoption into existing law and regulation, including the achievement of a stable platform for a reasonable period of time together with a commitment to cost : benefit considerations on the part of the IESBA.

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.*

As noted above, we believe that it is essential that changes to wording made in this project do not change the meaning of the Code and that matters that would involve potential such changes are identified and noted for further discussion by the IESBA so that they are subject to the Board's established due process. Whilst we do not comment on every possible change that may be problematic we do have concerns in respect to the following:

Professional or Business Judgement

Section 120 of the extant Code (Objectivity) refers to an obligation for professional accountants "...not to compromise their professional or business judgement because of bias, conflict of interest or the undue influence of others". The word "compromise" implies that a point may be reached at which any bias, conflict of interest or undue influence of others has reached a magnitude at which a particular judgement can no longer be regarded as sound, i.e., the judgement is compromised. This is the sort of circumstance that the Code's threats and safeguards approach was designed to deal with.

In deleting the word "compromised" in relation to judgement, proposed R112.1 interprets this as a requirement "to make professional or business judgements without bias, conflict of interest or undue influence of others." In practice it will be illusory to make a judgement with a complete lack of bias etc. Indeed

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R112.2, 112.2A1 seem to contradict proposed R112.1 in recognizing this: "...if a circumstance or relationship *unduly* (in italics for emphasis) influences the accountant's professional judgement".

We therefore suggest R112.1 be reworded in line with the extant wording so as to retain reference to potential compromise of judgement, as follows: "...not to ~~make~~ compromise their professional or business judgements ~~without~~ because of bias, conflict of interest or the undue influence of others."

Addition of Text to Sharpen an Extant Obligation

In drafting certain proposed subsections the IESBA has added text, which sharpens the extant obligation. For example, considerable new text (shown in italics) appears to have been added in para. R113.1, beyond the extant Code: "...*attain* and maintain professional knowledge and skill ... *based on current developments in practice, legislation and techniques* ...". In our opinion, adding this degree of detail may change the obligation, which is beyond the remit of this project. In particular, we do not believe it is appropriate for the IESBA to require knowledge and skill be based on "current techniques" without any explanation of what this is intended to mean. For example, it would be inappropriate to include techniques such as data mining software at the current time, given their current relative exclusivity to part of the profession.

Deleted Text

In drafting certain proposed subsections the IESBA has deleted text, which could have practical implications for the understanding of the extant obligation. For example, in subsection 115 references to a reasonable and informed third that would be drawn upon in determining whether a particular behavior adversely affects the good reputation of the profession do not include the following material currently in 150.1 of the Code: "weighing all the specific facts and circumstances available to the professional accountant at that time". We do not see justification for deletion, and believe that it should be retained in the interest of an individual professional accountant. We note that a somewhat fuller explanation of the concept of a reasonable and informed third party (although slightly different) is provided in 120.4A1. We suggest the Board consider this explanation more fully and the need to introduce cross-references thereto.

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Other Matters

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?*

Using a definition of audit (i.e. to include review) just for part of the Code remains very awkward. In particular it makes the Code susceptible to misunderstanding by readers not anticipating the attribution of a different meaning to terminology that is familiar to the profession and clients and often used in law. We suggest instead of retaining this awkward construct, the Code specify where particular paragraphs drafted for audits apply equally to review engagements.

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 have no comments in this context.

Title

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

The Explanatory Memorandum (paragraph 27) explains that the restructured Code should be titled “International Code of Ethics Standards for Professional Accountants”.

We would like to point out that the IESBA has not attempted to develop standards for all parts of the Code (only for independence) and accordingly the proposed title is a misnomer.

It is odd to refer to international independence standards only in the title and para. 4, Part C of the section headed Guide to the Code when the Code does not contain material that is clearly identifiable as standards. Should the relevant sections of Part C (currently numbered sections under C1 and C2) be entitled “international independence standards”? We suggest this needs further consideration.

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Request for General Comments

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.*

We reserve further comments until an ED showing the entire Code in restructured format is available.

- (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.*

We do not comment.

- (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.*

We reserve further comments until an ED showing the entire Code in restructured format is available.