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13 May 2016

Technical Director
International Ethics Standards Board for Accountants
545 Fifth Avenue, 14th Floor
New York, NY 10017 U.S.A.

Our Ref: 2016/JE/C1/IESBA/20

Subject Line: IESBA's Exposure Draft, *Improving the Structure of the Code of Ethics for Professional Accountants—Phase 1*

Dear Sir:

The International Organization of Securities Commissions' Committee on Issuer Accounting, Audit and Disclosure (Committee 1) appreciates the opportunity to comment on the International Ethics Standards Board for Accountants' (the IESBA or the Board) Exposure Draft, *Improving the Structure of the Code of Ethics for Professional Accountants—Phase 1* (the Paper). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through the promotion of high quality accounting, auditing and professional standards, and other pronouncements and statements.

Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting, disclosure and auditing concerns, and pursuit of improved global financial reporting. Unless otherwise noted, the comments we have provided herein reflect a general consensus among the members of Committee 1. Our comments are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.



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Overall Comments

We commend and support the Board's restructure of the Code in a "clarity" format and believe that the Paper provides a significant improvement over the extant Code. The proposed changes will provide greater certainty to practitioners and others in applying the Code, and will facilitate enforceability of the Code.

We support the proposed distinction between requirements and application guidance, as well as the clearer language. We also support the inclusion of a general framework and the prominence given to that framework. These changes are important to the enforceability, application and understanding of the Code.

In this letter, we comment on the apparently inadvertent changes in the meaning of particular provisions of the Code as the different sections of the Code were rearranged. We have included comments supporting certain aspects of the Paper and identified some instances where we believe the Code could be further enhanced in connection with the restructuring of the Code, by either clarifying or enhancing enforceability of certain sections. We have considered separately the Exposure Draft, *Proposed Revisions Pertaining to Safeguards in the Code-Phase 1* and will comment on this draft separately.

We also await the changes in Phase II of the project and Phase II of the Safeguards project, as well as any changes flowing from the Long Associations project.

Requirements

Paragraph 7 gives the impression that the inclusion of the word "shall" in a paragraph is the only criterion for identifying a requirement in the proposed Code. It should be made clear that an accountant must comply with all requirements where "shall" is used or if the paragraph is designated with an "R".

In particular, some "R" designated paragraphs use the language "which requires" (e.g. paragraphs R111.1, R113.1 and R114.1). These paragraphs should be reworded to specifically impose those requirements.



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Emphasis on general independence requirement and fundamental principles

As noted above, we support the prominence given to the proposed requirement to apply the conceptual framework of the Code. We believe the general independence requirement in paragraph R400.9 (supported by the definition in paragraph 400.2) should be given similar prominence.

The general independence requirement should be an overriding test, requiring the accountant to resolve a conflict and/or cease to be involved in an audit engagement. Greater prominence to the requirement will assist accountants in placing appropriate focus on the importance of this test.

The general requirement addresses situations and circumstances not specifically covered in the Code and assists in applying the specific requirements of the Code. Currently, many accountants appear to focus on specific requirements of the Code and disregard the general requirement to be independent. Further, the general requirement will assist in considering threats and safeguards in specific areas.

Compliance with the fundamental principles of integrity, objectivity, etc... in paragraphs R111.1, R112.1, R113.1, R114.1 and R115.1 should also be given more prominence. While we recognize and support the requirements to comply with the fundamental principles in paragraphs R120.5, R300.2 and similar provisions, it would also assist practitioners to emphasize in the Code that the general independence test and fundamental principles (including the requirement in R112.2 to not undertake an activity if the accountant's professional judgment would be unduly influenced) are overriding requirements that apply irrespective of other specific provisions in the Code.

Exceptions to the Code requirements

Paragraphs 10 and 11 suggest that there are instances where an accountant would not be required to comply with the specific requirements in circumstances where they consider it appropriate not to do so, albeit after consultation with other parties. The Board should consider removing such exemptions as they undermine the specific requirements of the Code, may conflict with the general independence requirement, and may be inconsistent with the



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comment in paragraph 6 that the Code requires compliance with the fundamental principles of professional ethics.

The equivalent of the proposed paragraph 10 is not located under the common subheading “Exceptional circumstances” in the extant Code. Relocating the paragraph may affect the interpretation of these provisions. In particular, paragraphs 10 and 12 read together imply that the accountant could decide not to apply specific provisions of the Code on the basis that compliance would be disproportionate to the public interest under paragraph 10. At present the equivalent to paragraph 10 in the Code does not appear to allow the accountant to make a decision not to apply any of the specific provisions. Further paragraph 12 would “encourage” rather than require the accountant to document the reasons for such a decision.

Further, the meaning of paragraph 11 appears to have been changed. Extant paragraphs 100.19, 100.20, 100.21, 100.23 and 100.24 relate to “Ethical Conflict Resolution” and internal resolution processes. This is evident from the wording of those paragraphs and the context provided in extant paragraphs 100.17 and 100.18 preceding them under the heading “Conflicts of interest”. In contrast paragraph 11 relates to circumstances where compliance with one principle of the Code is in conflict with compliance with another, increasing the discretion in applying the Code. If paragraph 11 is to be retained, it should only apply in the context of conflicts of interest.

If the current proposals are retained, section 12 should require rather than encourage documentation of the decisions made. Similarly, paragraphs 10 and 11 should require consultation rather than encourage consultation. The use of the softer wording “encourage” would not appear to be consistent with the approach of the current Board to strengthen the Code, provide greater clarity and avoid perceptions of undue influence from the profession.

Subject to addressing these matters, paragraphs 10 to 12 should become integral parts of the Code itself rather than being included in the “Guide to the Code”. Presenting the provisions as introduction and guidance could cause some professionals to overlook the importance of these provisions and focus only on the other provisions of the Code.

Use of “it is generally necessary”

Some provisions of the proposed Code preface actions by the accountant with the words “it is generally necessary”. These provisions would provide too much subjectivity, lack clarity and



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would be difficult to enforce. An example is paragraph 310.11.A2. We suggest making such provisions requirements.

Treatment of Code as a Standard

We support the inclusion of “Standards” in the title of the proposed Code to emphasize the importance and status of the requirements of the Code.

Scope of parts of the Code

The independence provisions of the extant Code apply separately to:

- (i) financial statement audits (section 290); and
- (ii) audits or reviews of information other than historical financial information (section 291).

It is proposed to restructure the Code to apply separately to:

- (i) audit and review engagements (section C1); and
- (ii) other assurance engagements (section C2).

Section C2 has not yet been included in the proposed Code. The purpose of the section is unclear given that the ISAs do not envisage assurance engagements other than audits and reviews.

We would support combining the extant sections 290 and 291 into a single section.

“Reasonable and informed third person” test

We support the use and definition of the concept of a “reasonable and informed third person” (refer to paragraphs R120.4 and 120.4 A1 and the glossary). Nonetheless, please consider suggestions for improvements to the definition as part of the submissions on the IESBA’s Exposure Draft, *Proposed Revisions Pertaining to Safeguards in the Code-Phase 1*.



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Identifying threats

Extant paragraph 100.6 explains that the Code includes a conceptual framework to address the broad range of circumstances that can create threats to compliance with fundamental principles. In contrast, paragraphs R120.5 A1 and A4 appear to suggest that the broad range of circumstances that can create threats to compliance with fundamental principles may affect the likelihood of an accountant identifying threats. We are concerned that the proposed paragraphs might be used inappropriately to justify not identifying a particular threat.

The proposed Code should be clear that the accountant has an obligation to identify all threats to compliance with the fundamental principles, regardless of how many threats exist or other circumstances. The threats identified are then evaluated, addressed and a determination made as to whether they have been reduced to an acceptable level.

Sufficiency of safeguards, etc...

Certain paragraphs of the proposed Code require an assessment as to whether safeguards are necessary to address a threat (e.g., refer paragraph R510.10(b)(ii)). These provisions should also require the auditor to determine whether the safeguards are sufficient to address the threats and, if not; require action such as ceasing to be the auditor before issuing an opinion.

Similarly, paragraph R310.11 requires an accountant to judge whether specific disclosure and explicit consent is necessary in relation to a conflict of interest but should also require the accountant to determine whether this would be sufficient or other actions are required.

“Trivial and inconsequential” criterion

A number of paragraphs of the proposed Code use the “trivial or inconsequential” criterion. For example, paragraph 340.3 A1 applies the concept to the “existence” and “significance” of a threat relating to gifts and hospitality. The concept is highly subjective and the Board should consider providing a definition or guidance on its application.

“Materiality” and “significance”

Certain provisions of the proposed Code would apply subject to “materiality” and “significance” (e.g., refer to paragraph 520.2 in connection with business relationships).



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Guidance should be provided on the application of the “materiality” and “significance” criteria, which might include:

- (a) a reasonable third party criterion;
- (b) given that the proposed Code refers to the “combined net worth” of an individual as a measure of “materiality” and “significance”, the need to consider qualitative factors such as the nature of the business relationship between the individual and the audit firm, and whether such relationship/service affects the financial statements;
- (c) the need to consider the “perception” or “appearance” of independence; and
- (d) the need to apply the test in the context of a network, individual firm and an individual engagement.

Documentation

Paragraph 402.1 would require documentation evidencing “judgments when forming conclusions regarding compliance with independence requirements”. The documentation should be required to be of a standard that would enable another professional to understand the judgments made and the reasons. Guidance should be provided on the extent of documentation required in relation to matters such as the identification of risks, and evaluation of threats that were determined to be acceptable without safeguards.

This guidance in paragraph 402.2 A1 says that a lack of documentation does not determine whether a firm has considered a particular matter or whether it is independent. This paragraph is unnecessary and can undermine the documentation requirements and their enforceability. The paragraph should be removed.

Relationships and services

It is unclear why paragraph R400.13(a) is limited to financial or business relationships that exist during the period covered by financial statements prior to accepting the audit engagement and not to such relationships after accepting the audit engagement. Similarly, it is unclear why paragraph R400.13(b) applies to services prior to becoming auditor of an entity.

If subsequent relationships and services are considered to be covered by other parts of the proposed Code, this should be made clear and the provision should only apply to new audit



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clients. It should be stated that all prohibited relationships/services must be terminated prior to accepting the engagement and that other parts of the proposed Code address ongoing/continuing prohibited services to the audit client, if any.

Breaches

Depending upon the significance of a breach of an independence requirement of the Code, paragraph R404.2(e) would require ending an audit engagement or taking other appropriate action. It should be made clear that other action is not appropriate where another requirement of the Code requires the engagement to be ended.

Definitions

We suggest the following enhancements to definitions in the glossary:

- (a) *Engagement period* – the period should not be limited to the date that the audit report is issued as the auditor has further responsibilities, such as addressing the effect on the opinion of matters that come to the auditor’s attention after conclusion of the audit; and
- (b) *Financial interest* – the definition may need to be broadened to cover interests such as financial interests in a trust.

Other matters

Other specific matters that the Board should consider are:

- (i) The following paragraphs of the “Introduction” at the start of individual parts of the Code are in the nature of application guidance and should be relocated to the application content, including:
 - The guidance on “materiality” and “significance” in paragraphs 510.3 and 520.2; and
 - the guidance on what constitutes a network firm in paragraph 401.1;



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- (ii) In paragraph R100.4(b) there should be no optionality on whether an accountant has to report a breach or not;
- (iii) Including the following content from extant paragraph 100.12 in the proposed Code:
"When a relationship or circumstance creates a threat, such a threat could compromise, or could be perceived to compromise, a Member's compliance with the fundamental principles.";
- (iv) In the first line of paragraph 300.1, consider replacing "considerations" with "requirements and guidance", consistent with the restructuring of the Code;
- (v) In paragraphs 310.3 and 310.4, whether threats and conflicts "might" exist in the cases outlined or should be described as existing;
- (vi) Some requirements seem to point to the conceptual framework rather than containing specific requirements or actions for the accountant to take (for example, see R330.3; R340.3). These paragraphs should contain such requirements;
- (vii) Paragraph R340.3 says "A professional accountant shall apply the conceptual framework set out in Section 120 to the acceptance of offers of gifts and hospitality." This requirement does not provide much accountability and may be difficult to enforce. Perhaps this requirement could say, "A professional accountant shall not accept gifts or hospitality that a reasonable and informed third-party, weighing all the facts and circumstances, would not consider trivial and inconsequential or would conclude that the offer is not made in the normal course of business without the intent to influence decision making or to obtain information". Even though current paragraph 260.2 does not use the verb "shall" it provides guidance about the nature of circumstances that would or would not be problematic;
- (viii) In paragraph 400.4, removing the reference to 300.2 A10, which does not include safeguards as suggested;
- (ix) Relocating the material in paragraphs 300.2 A1, A3, A4, A5 and A6 to other more directly related parts of the proposed Code;



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- (x) The requirement in paragraph R401.2 for a network firm to be independent of audit clients of other firms in the network should apply even where there is no specific requirement in C1;
- (xi) Some application material is definite and could be considered to be requirements. For example, 401.3 through 401.9; 410.7 A1, 521.4 A1;
- (xii) In paragraph 511.4 A2 and other provisions, review by another network firm is not really a safeguard because of the mutuality of interest between firms in the same network; and
- (xiii) In paragraphs R521.5 and R521.6, it is inappropriate in addressing “Other Close Relationships of Audit Team Member” to have a requirement that only requires “consulting in accordance with firm policies and procedures”.

Thank you for the opportunity to comment on the Paper. If you have any questions or would like to further discuss these matters, please contact either Nigel James or me at 202-551-5300.

Sincerely,

Julie A. Erhardt
Chair, Committee on Issuer Accounting, Audit and Disclosure
International Organization of Securities Commission