

19 May 2017

Mr. Ken Siong
Technical Director
International Ethics Standards Board for Accountants (IESBA)
International Federation of Accountants (IFAC)
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By email: kensiong@ethicsboard.org

Dear Mr. Siong,

RE: IESBA's Exposure Draft *Improving the Structure of the Code of Ethics for Professional Accountants – Phase 2*

Accounting Professional & Ethical Standards Board Limited (APESB) welcomes the opportunity to make a submission on the IESBA's Exposure Draft *Improving the Structure of the Code of Ethics for Professional Accountants – Phase 2* (Structure 2 ED).

APESB is governed by an independent board of directors whose primary objective is to develop and issue, in the public interest, high-quality professional and ethical pronouncements. These pronouncements apply to the membership of the three major Australian professional accounting bodies (CPA Australia, Chartered Accountants Australia and New Zealand and the Institute of Public Accountants). In Australia, APESB issues APES 110 *Code of Ethics for Professional Accountants* which includes the Australian auditor independence requirements, as well as a range of professional and ethical standards that address non-assurance services.

Introductory comments

APESB is supportive of the IESBA's project to restructure the existing Code. We believe that a restructured Code will raise the visibility of the Code's requirements, simplify the Code's language and assist professional accountants in understanding and applying the requirements of the Code.

We commend the IESBA in undertaking this major project and for the Board's efforts to ensure that the extant Code's requirements and guidance is maintained in Structure 2 ED. We believe that IESBA has achieved this objective subject to APESB's key recommendations in this submission.

APESB is supportive of the effective dates for the restructured Code. We strongly support the IESBA's plan to monitor developments in respect of the proposed long association provisions, including the review of the impact of the proposed jurisdictional clause before its expiry on 15 December 2023. It is imperative that this review should include gathering and consideration of empirical information relating to the impact of auditor rotation on audit quality.

In developing APESB's response to the Structure 2 ED, we have taken into consideration Australian stakeholders' feedback from two roundtable events conducted by APESB in Melbourne and Sydney in March 2017. APESB has also considered the Compilation of Proposed Restructured Code issued by the IESBA in conjunction with the release of the Structure 2 ED in January 2017.

Key Recommendations

APESB's key recommendations for the IESBA's consideration are:

- strengthen the general requirements in each section to ensure the requirements are clearly set out and understandable if the section is read in isolation;
- enhance the requirements in the Code by removing from requirements paragraphs the need to meet obligations in application material (refer to page 4);
- clarify specific provisions by removing or revising specific phrases to remove limitations or to enhance the readers' ability to understand the provision (refer to pages 4 - 6);
- perform a review of the Structure 2 ED in respect of instances where the term 'might' is used to ensure it is applied consistently with the drafting conventions;
- consider implementing consistent numbering of sections in Part 4A and Part 4B;
- consider adopting a simpler sequential numbering system that will clearly define the relationships between the requirements and application material in the Code; and
- relocate the glossary to the beginning of the Code, preferably after the Guide to the Code.

Further information on APESB's key recommendations and other comments are included in Appendix A and specific editorial comments are included in Appendix B for the IESBA's consideration.

Concluding comments

We trust you find these comments useful in your final deliberations. Should you require any additional information, please contact APESB's Chief Executive Officer, Channa Wijesinghe at channa.wijesinghe@apesb.org.au.

Yours sincerely



The Hon. Nicola Roxon
Chairman

Appendix A

APESB's Comments

APESB's responses to the specific matters raised by the IESBA in the Structure 2 ED are as follows:

Specific Matters

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 (see Sections 200-270 in Chapter 1)?**
 - **The NOCLAR provisions (see Sections 260 and 360 in Chapter 2)?**
 - **The revised provisions regarding long association (see Sections 540 and 940 in Chapter 3)?**
 - **The provisions addressing restricted use reports in the extant Code (see Section 800 in Chapter 4)?**
 - **The provisions relating to independence for other assurance engagements (Part 4B in Chapter 5)?**

If so, please explain why and suggest alternative wording.

Subject to APESB's comments below, APESB is supportive of the proposals in the Structure 2 ED. The restructured provisions have made the Code easier to read and understand, which in turn will facilitate implementation of the Code and promote compliance among professional accountants.

However, APESB believes that in some cases the streamlining of the requirement to comply with the conceptual framework has weakened the extant requirements in the Code. The proposed approach in the Structure 2 ED is that a reference to complying with the conceptual framework is included in the introduction paragraphs of each section. This works well when there is a clear requirement within the section that a professional accountant must comply with.

But in circumstances where there is no requirement listed within the section, there is a risk that professional accountants will not understand their responsibilities and may not make the necessary connection back to the conceptual framework. This is because the introduction paragraphs are not designated as either a requirement or an application paragraph. There is a risk that this material will not be referred to or relied upon by users when they are considering the content of each section, especially if they navigate through the Code electronically.

This situation is clearly seen when you compare like sections such as the sections on gifts and hospitality in the proposed Parts 2 and 3. In section 420, which applies to professional accountants in public practice, there is a clear requirement about when the professional accountant can or cannot accept gifts and hospitality. In contrast section 340, which applies to professional accountants in business, contains application material about potential threats and the level of those threats but has no clear requirement.

APESB believes that section 340 would be improved if it included a requirement paragraph such as '*A professional accountant shall not accept an offer of gifts or hospitality if threats to the fundamental principles cannot be eliminated or reduced to an acceptable level.*

APESB recommends that the IESBA conducts a comprehensive review of sections to ensure the requirements are clear and can be understood if they are read in isolation.

Requirement paragraphs are also being weakened when they refer to obligations in application paragraphs. APESB has noted a few instances where this has occurred as noted below;

- Paragraph R220.10 requires a professional accountant to exercise professional judgement to determine the necessary steps to undertake to fulfill the responsibilities in paragraph 220.7 A1.
- Paragraph R260.26 specifies that in exceptional circumstances, a disclosure to authorities of a NOCLAR by an accountant is not a breach of confidentiality if it is made pursuant to 260.20 A2 and A3.

APESB recommends that the IESBA conduct a thorough review of requirements paragraphs and amend any that refer to application paragraphs so that the specific matters outlined in the application material are captured in the requirements paragraph.

While most of the proposals have improved the clarity of the extant provisions, the APESB has noted that there could be further improvements made in respect of the following matters:

- Use of professional judgement for imminent breach of NOCLAR

There is an opportunity to link paragraphs R 260.22 and 260.22 A1 (and R360.27 and 360.27 A1) in respect of what a professional accountant should do in exceptional circumstances where there is an imminent breach of law or regulation. In the extant NOCLAR provisions the content in these paragraphs were combined, and APESB is concerned that the connection may be lost when split into two paragraphs as proposed in the Structure 2 ED.

APESB recommends that the following extant sentence is retained and replaces the proposed second sentence in paragraph R260.22 and application paragraph 260.22 A1:

‘Having considered whether it would be appropriate to discuss the matter with management of those charged with governance of the entity, the professional accountant shall exercise professional judgement and may immediately disclose the matter to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach of law or regulation.’

We believe that this drafting makes the process to be followed clear.

- Clarity on the provision of engagement letters to a group of lenders

Professional accountants are required to make users, or their representative, aware of any restrictions on use or distribution of reports prepared applying modified independence requirements (paragraph R800.3).

In the application material in paragraph 800.3 A2, we believe that the phrase in the second sentence “*to meet the requirement for the firm*” might be misinterpreted to mean that accountants’ compliance with the above requirement is dependent on the specific actions of the users’ representative.

We recommend that this sentence be changed to:

“The representative might then make the firm’s engagement letter available to the members of a group of lenders ~~to meet the requirement for the firm to make such users aware of the modified independence requirements agreed to by the representative~~”.

- Limitation implied by the phrase ‘contractual or regulatory outcomes’

Paragraphs R220.8 and 220.7 A1 set out that professional accountants should not prepare or present information that is misleading or will inappropriately influence “*contractual or regulatory outcomes*”.

APESB is of the view that the phrase “contractual or regulatory outcomes” is limiting. We recommend that the requirement should be extended to also cover *commercial outcomes*.

- Clarity of provisions on the preparation and presentation of information

There are a number of instances where the language or phrases used in Section 220 do not seem appropriate and may result in varying interpretations of the provisions. For example, paragraph 220.7 A1 refers to estimates being used for debt covenants or capital requirements, but in practice actual financial results are used not estimates.

Paragraph 220.8 A1 also contains a number of instances where the words used could be confusing to the reader. One such instance is a listed example where users are referred to two different accounting policies permitted under the applicable financial reporting framework. We would respectfully note that if the relevant accounting policies are permitted then it should not imply that this would lead to an improper accounting outcome. Therefore APESB suggests the alternative wording below should be used to improve the clarity of this paragraph:

220.8 A1 Examples of ways in which discretion might be misused to achieve inappropriate outcomes includes:

- *Determining estimates, for example, ~~determining~~ preparing fair value estimates in ~~order to~~ a manner that will misrepresent profit or loss.*
- *Selecting or changing an accounting policy or method among two or more alternatives ~~permitted under the applicable financial reporting framework where the application of one alternative is doubtful~~, for example, selecting a policy for accounting for long-term contracts in order to misrepresent profit or loss.*
- *~~Determining~~ Influencing the timing of transactions, for example, timing the sale of an asset near the end of the fiscal year in ~~order to mislead~~ a manner that does not reflect the true financial position of the entity.*
- *Determining the structuring of transactions in an inappropriate manner, for example, structuring financing transactions in order to misrepresent assets and liabilities or classification of cash flows.*
- *Selecting inappropriate disclosures, for example, omitting or obscuring information relating to financial or operating risk in order to mislead.*

- Use of the term 'Professional Activity'

APESB has noted a number of instances where the provisions refer to *assignments* or *services* (for example, paragraphs 113.1 A3, R113.3 and R115.2(a)). APESB is of the view that the term *professional activity* is more appropriate, as it is a defined term in the Code and applies to both professional accountants in business and in public practice. APESB recommends that the IESBA review the references throughout the Code to *assignments* or *services* to consider if *professional activity* should be used instead.

Additional comments noted from APESB's review of the Compilation of Proposed Restructured Code are noted below:

- Independence and the Conceptual Framework

APESB notes the addition of paragraph 120.12 A1 to highlight the importance of independence in relation to audits, reviews, or other assurance engagements. However, APESB believes this paragraph should be a requirement and phrased as;

'Professional accountants in public practice shall be independent when performing audits, reviews and other assurance engagements. Independence is linked to the fundamental principles of objectivity and integrity'.

APESB is of the view that the definition of independence should be removed from section 120 as it is duplicating the material in the Glossary, and Parts 4A & 4B and is not necessary in that section from a user's perspective.

- Cross references to breaches of the fundamental principles

Paragraph R100.4 sets out the required actions for professional accountants when they identify a breach of the Code. The paragraph starts by referring to specific sections in Part 4A and Part 4B which deal with breaches of independence. However, this requirement relates to compliance with the fundamental principles in general and is not limited to independence breaches. We therefore recommend that the references to independence-related paragraphs be removed.

- Clarity of requirements relating to providing non-assurance services to an audit client

The proposed paragraph R600.10 is lengthy and complex with the two different lists of factors. APESB suggests that this paragraph be amended as follows:

R600.10 *Section 600 prohibits assuming management responsibilities or providing certain non-assurance services to audit clients. As an exception to those requirements, a firm or network firm may assume management responsibilities or provide non-assurance services that would otherwise be prohibited to the following related entities of the audit client ~~on whose financial statements the firm will express an opinion:~~*

(a) *An entity that has direct or indirect control over the client;*

(b) *An entity with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity;*
or

(c) *An entity which is under common control with the client,*

~~provided that all of the following conditions are met the firm or a network firm does not:~~

- ~~(i) The firm or a network firm does not express an opinion on the financial statements of the related entity;~~
- ~~(ii) The firm or a network firm does not assume a management responsibility, directly or indirectly, for the entity on whose financial statements the firm will express an opinion; and~~
- ~~(iii) perform The services that do not create a self-review threat because ~~the results of the services~~ those services with results will not be subject to audit procedures.; and~~
- ~~(iv) The firm applies the conceptual framework to eliminate any threats created or reduce them to an acceptable level.~~

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?

Overall APESB believes that the proposals are consistent with the key elements of the restructuring described in the Explanatory Memorandum of the Structure 2 ED subject to our comments below.

Inappropriate use of 'might' and 'may'

APESB notes the application of the IESBA's drafting guidelines on the use of 'may' or 'might' throughout Structure 2 ED. However, we have identified some instances where the use of the term 'might' may be inappropriate as noted below:

- inappropriately used in paragraph R115.1 (second sentence) when it specified that a professional accountant shall not engage in business, occupation or activities that impairs or '*might impair*' integrity, objectivity or good reputation. We believe that in its place, it is more appropriate to state "...*that impairs or is perceived to impair*".
- unnecessarily added in the first sentence in paragraph 200.2, i.e. '*Investors, creditors, employers...rely on the work of professional accountants in business*'. It is a factual statement and does not need the term 'might'.

We propose that the IESBA perform a critical review of the Structure 2 ED of where the term 'might' is used to assess whether any other extant provisions have been inadvertently diluted or changed.

Complex numbering system

APESB believes that the alpha-numerical referencing proposed by the IESBA is complex and cumbersome. The long numbering system might cause difficulties when professional accountants need to cross-reference their policies and procedures with the requirements of the Code.

We also found at times that the rationale behind the numbering of application material paragraphs is not clear. For instance:

- Paragraphs 220.4 A1 – 220.7 A1 in Section 220 *Preparation and Presentation of Information* did not have any specific requirements. Moreover, the changes in paragraph numbers are confusing, i.e. 220.4 A1 was followed by 220.5 A2, 220.6 A1 and 220.7 A1.

If these paragraphs were related to a specific requirement, then the numbering would have been 220.4 A1, 220.4 A2 and so on.

- Similarly, NOCLAR application material paragraphs 260.4 A1 – 260.4 A2 were not clearly related to specific requirements.

We propose that the IESBA consider adopting a shorter and simpler sequential numerical system that will:

- define requirements and application material based on the existing approach applied by standards setters such as IAASB, IFRS and APESB; and
- clearly establish relationships between requirements and application material.

Relocating the Glossary to be after the Guide

APESB recommends that the Glossary is relocated to be positioned after the Guide to the Code. This would be consistent with the practice used by most standard setters and legislators to provide definitions at the beginning of a document rather than at the end.

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.**

APESB's comments on the conforming amendments are included in our submission relating to the IESBA's Exposure Draft *Proposed Revisions Pertaining to Safeguards in the Code – Phase 2 and Related Conforming Amendments*.

Effective Date

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

APESB is supportive of the proposed effective dates for the restructured Code.

APESB also strongly supports the IESBA in its plan to monitor developments in respect of the implementation of the long association provisions and the review of the effects of the jurisdictional clause before its expiry on 15 December 2023. APESB is of the view that for such a review to be effective, it should include gathering and consideration of empirical information relating to the impact of auditor rotation on audit quality.

General Comments

APESB's responses to the general matters raised by the IESBA are as follows:

(a) Small and Medium Practices (SMPs) and PAIBs

APESB believes the proposals in the Structure 2 ED such as the simplified language and increased clarity of responsibilities of firms and individual professional accountants in public practice will assist SMPs in understanding and applying the Code.

(b) Regulators and Audit Oversight Bodies

Not applicable.

(c) Developing Nations

Not applicable.

(d) Translations

Not applicable.

Appendix B

Other Editorial Amendments

APESB also recommends the following editorial amendments for the IESBA's consideration:

- Amend paragraph 110.3 A2 to be consistent with other provisions as follows '*The professional accountant is required or encouraged, depending on specific circumstances, to document the substance of the issue...rationale for those decisions.*';
- Amend paragraph 240.2 to include the word "*threat*" in the second sentence, as follows:

"Self-interest threat to compliance with the principles of objectivity or confidentiality....to manipulate price-sensitive information";
- Update paragraph 100.4 A1 to include '*those charged with governance*' of a client as one of the relevant parties who might be affected and to whom a report about a breach might be reported;
- To enhance presentation, we suggest that the examples in paragraph 120.7 A2 be transferred to paragraph 120.6 A1;
- Review for consistent use of the drafting guidelines in relation to the term professional accountant (for example paragraph 220.9 A2 is missing the word 'professional' and paragraph R220.12 continues to use the full phrase 'professional accountant' when after the first use the subsequent references could be to 'accountant');
- Revise paragraph 321.5 A1 as follows '*...providing a second opinion to an entity that ~~are~~ is not an existing client is are the*';
- Revise the first dot point in paragraph 320.6 A4 to include the word 'of' after the words 'the professional accountant need to be aware';
- Review paragraph 360.18 A2 which is unclear and refers to inquiries being made of publicly available information;
- Review paragraph R230.5 to clarify to whom the professional accountant shall communicate;
- Review paragraph 922.5 A3 to clarify who is responsible for completing the review of the work performed;
- Review paragraph R910.10 and consider whether an additional option is for the assurance team member to be removed from the engagement;
- Remove the sunset provision in paragraph R540.18 in the compiled Code (January 2017), consistent with the same paragraph in the Structure Phase 2 ED;
- Review the cross reference in paragraph 400.53 A9 which directs readers to paragraph R400.52(f) but we believe should be to R400.53(f);
- Review the cross reference in paragraph 400.40 which directs readers to paragraph R300.8 but we believe should be to R300.9;
- Review the cross reference in paragraph 300.6 A1 which directs readers to paragraph 120.5 A3 but we believe should be to 120.6 A3;
- Review the cross reference in paragraph R400.53 (d) which directs readers to paragraph 400.52 A5 but we believe should be to 400.53 A5;

- Review the cross reference in paragraph 924.6 A2 which directs readers to paragraph 924.4 A1 but we believe should be to 924.6 A1;
- Review the cross reference in paragraph R510.8 which directs readers to paragraph 510.7 (c) or (d) but we believe should be to R510.7 (c) or (d);
- Remove from paragraph 905.10 A2 the words '*or otherwise advise as necessary*';
- Reviewing the Structure 2 ED and the Compiled Code content for incorrect punctuation (paragraphs R114.1(a), 120.6 A3(b), 300.6 A1 (c), 310.5 A3, R510.8 (a) and 911.4 A1);
- Review the sections for consistent numbering convention, for example the numbering convention for paragraphs 604.12 A3 to 604.14 A1 is different to the numbering applied to similar provisions in paragraphs 604.16 A2 to 604.16 A4; and
- Review numbering of paragraphs 400.40, 321.4, 900.4 (c) and (d) and R900.20 (a) within the Compiled Code document.