

18 April 2016

Mr Ken Siong
Technical Director
International Ethics Standards Board for Accountants
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, NY 10017
USA

Dear Ken,

IESBA Exposure Draft *Improving the Structure of the Code of Ethics for Professional Accountants-Phase 1*

Thank you for the opportunity to comment on the IESBA exposure draft of Phase 1 of proposals to improve the structure of the Code. We submit the feedback from the New Zealand Auditing and Assurance Standards Board (NZAuASB) in the attachment.

Overall summary

As previously commented to IESBA, the NZAuASB is very supportive of the project to improve the structure of the Code. The NZAuASB considers that the primary purpose of the Code of Ethics is to guide professional accountants to work through ethical conflicts as they emerge. The NZAuASB is strongly in favour of enhancing the existing framework that emphasises not only the importance of the conceptual framework but which is strongly focussed on compliance with the fundamental principles. The NZAuASB considers that a robust framework will encourage compliance with the spirit of the Code, whereas a rules based approach may drive a compliance focus, where professional accountants make use of a “tick the box” approach to compliance with the requirements. The NZAuASB acknowledges that the IESBA is mindful of the importance of a principles-based approach, with principles that can apply in all circumstances, and strongly encourages the IESBA to retain that approach

The NZAuASB considers that the length and complexity of the existing Code is a barrier to adoption and implementation and is therefore very supportive of all efforts to simplify the drafting conventions and shorten the Code. Once simplified drafting conventions are established, the NZAuASB then encourages IESBA to ensure that the Code is consistently restructured in line with those revised drafting conventions. The NZAuASB encourages the IESBA to continue to seek ways to further simplify the Code, reduce repetition and shorten the Code with a focus on the fundamental principles in line with revised drafting conventions.

One key area where the NZAuASB considers that the proposals could be improved is in consistent use of terminology. Areas that the NZAuASB has identified where the use of terminology could be improved are highlighted in response to the specific questions posed in the exposure draft in the attachment. The NZAuASB considers that consistent use of terminology is key to avoiding unintentional breaches of the Code. Professional accountants are unlikely to read the Code from cover to cover, rather, in practice, a specific section or paragraph will be referred to that most closely deals with the ethical dilemma the professional accountant is facing. If that paragraph is inconsistent in the terminology that it uses, it may lead to unintended consequences. Consistency in use of terms, using shorter sentences and having a clear structure are all important to improving the usability of the Code.

In formulating this response, the NZAuASB sought input from New Zealand constituents.

Should you have any queries concerning our submission please contact either myself at the address details provided below or Sylvia van Dyk (sylvia.vandyk@xrb.govt.nz).

Yours sincerely,
Neil Cherry

A handwritten signature in blue ink, appearing to be 'Neil Cherry', with a large, sweeping flourish at the end.

Chairman – New Zealand Auditing and Assurance Standards Board

Email: neil.cherry@xrb.govt.nz

Submission of the New Zealand Auditing and Assurance Standards Board
IESBA Exposure Draft *Improving the Structure of the Code of Ethics for Professional Accountants-Phase 1*

I Schedule of Responses to the IESBA's Questions

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?

Response:

The NZAuASB considers the proposed guide is useful and understandable. The addition of paragraph 3 is helpful as it provides a link between objectivity and independence.

The NZAuASB considers that paragraph 4 may be enhanced by adding similar wording as included in section 300.1, i.e. to expand that Part B and C describe considerations for either the accountant in public practice or in business **in the application of the conceptual framework**, to provide emphasis to the application of the conceptual framework.

The NZAuASB urges the IESBA to continue to pursue ways to shorten and simplify the Code. As previously recommended, and as outlined in response to question 1(f)(ii) below, eliminating the duplication included by repeating most of section 290 in section 291 makes the Code unnecessarily lengthy. With the use of an electronic code, the NZAuASB considers that the length of the Code could possibly be significantly reduced. For example, if a professional accountant had to pre-select a few options prior to accessing the code, including the type of engagement or work the accountant is performing, an electronic code could hide irrelevant sections and could use appropriate words for that context. The longer the Code, the less accessible it becomes and the more likely that a nuance is overlooked if it is buried in dense text that is difficult to understand.

In addition, the NZAuASB urges the IESBA to continue to explore ways to simplify the drafting conventions and clarity of language even further. Whilst the proposals are an improvement, the NZAuASB considers that consistent application of revised drafting conventions, consistent use of terminology, further simplification, use of shorter sentences, additional use of bullet points and use of the active voice will further enhance the understandability of the Code.

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

Response:

The NZAuASB considers that labelling requirements with R and application material with A are helpful clarifications. The paragraph numbers that are requirements are in bold. The NZAuASB recommends that it may also be useful to bold letter the entire paragraph of the requirements rather than just the paragraph number.

The NZAuASB is supportive of retaining the application material in close proximity to the requirement to which it relates, rather than grouping requirements together and application material separately.

Proposed R524.5 and R524.6 should have a "shall not" if it is a requirement rather than referring to independence being compromised, to be consistent with the drafting rules that a requirement should contain "shall". 524.7 A1 could then be phrased as an exception to R524.5 and 6. As the requirement refers to a key audit partner joining the audit client, the prohibition would apply to the firm retaining the engagement.

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

Response:

The NZAuASB is very supportive of enhancing a robust principled framework rather than creating a focus on the application of rules. The NZAuASB is supportive of proposed enhancements to the conceptual framework but

considers a focus and emphasis on compliance with the fundamental principles is also necessary and could be more prominently emphasised than what is proposed.

The IESBA is proposing to include a header “The conceptual framework contained in section 120 applies in all circumstances” on every page. The NZAuASB is supportive of all attempts to emphasise the fundamental principles and conceptual framework approach rather than positioning this just as background information. The NZAuASB considers that it would be even more helpful to put additional emphasis on the fundamental principles and not just on the conceptual framework. Linking each sub-section to a fundamental principle as done in the past in New Zealand placed an even greater emphasis on the overarching principled approach. Repeating the same header throughout the Code is not in itself that helpful as one may soon stop reading or referring to it.

As previously raised by the NZAuASB, we continue to recommend that the Code should be structured around the fundamental principles. Use of the header may bring the conceptual framework more to the front of mind, but linking each sub-section to a fundamental principle makes it easier for practitioners to apply the conceptual framework, and to identify and evaluate the relevant threats. The NZAuASB recommends that the header for each section in Part C should be customised to place greater emphasis on the fundamental principles together with the conceptual framework. For example, in section 310 the header could be worded as follows:

“A conflict of interest creates threats to the fundamental principle of objectivity. The conceptual framework contained in section 120 applies in all circumstances”.

Within the introduction of each section, there is a reference to the threat to a fundamental principle. In some instances, a specific principle is identified and in others all the principles are referred to. The NZAuASB considers that the link to these identified fundamental principles should be more clearly emphasised, more examples may be helpful and including the specific fundamental principle identified in the header together with the reminder on the conceptual framework would promote the focus on the fundamental principles together with the threats and safeguards approach. This would require each section to start on its own page.

For example, the following sections could have the relevant fundamental principle emphasised in the header, as already identified in the text of the code as referenced below – varying the header may promote the reader to continue to refer to it:

- Section 310 Conflicts of interest – Objectivity (as referred to in 310.2) and possibly other fundamental principles
- Non-compliance with laws and regulations – Integrity and Confidentiality
- Section 320 Professional Appointment – Professional Competence and Due Care, Professional Behaviour and Objectivity and possibly others? Section 320.2 generically refers to the fundamental principles. If the IESBA considers that all fundamental principles are equally relevant then all should be referred to in the header.
- Second opinions – Professional Competence and Due Care (section 321.3)
- Fees and other types of remuneration – Professional Behaviour and possibly others (section 330.2)
- Gifts and hospitality – Objectivity (section 340.2)
- Custody of client’s assets – Professional Behaviour and Objectivity (section 350.2)
- Independence - Objectivity

The NZAuASB notes that the introductory paragraph that describes the five fundamental principles (110.1) does not indicate that these are requirements, rather there is a requirement to comply with each specific principle in the subsections that follow. The NZAuASB recommends amending 110.1 to read “...five fundamental principles of ethics that for professional accountants are required to comply with.” indicating the requirement in this overarching paragraph is important. If there is one paragraph that summarises the Code, it is this section 110.1 and it should indicate that following these fundamental principles is a requirement of the profession.

As outlined in the back of the mapping document, there are a number of added new requirements that refer to “the professional accountant (or firm) shall apply the conceptual framework set out in Section 120 to(fees or other remuneration) or other applicable subsections”. For example R410.2, R411.2, R430.2, R510.4, R511.3, R520.3, R521.2, R522.2, R524.2, R525.2 etc. The NZAuASB does not consider that these added requirements are particularly helpful – the requirement to apply the conceptual framework set out in section 120 applies in all circumstances, therefore it appears to be unnecessarily repetitive to require application of the framework in each identified scenario too.

An alternative option to using the header approach would be to include a table to introduce each section, with key words to highlight the fundamental principle considered and the threats identified. For example:

| Section 330 | Fundamental principle | Threats | Differs for assurance | Cross reference |
|-----------------------------|---|---|-----------------------|-----------------|
| Fees and other remuneration | Professional competence and due care | Self-interest Advocacy Intimidation | Yes | |
| Contingent fees | Professional competence and due care Integrity | Self-interest | Yes | C1 and C2 |
| Referral fees (Commissions) | Objectivity Professional competence and due care | Self-interest | Maybe | |

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

Response:

Consistent and appropriate use of terminology is also important to clarify responsibility. The NZAuASB does not consider that using the term “firm” for ease of reference is appropriate in proposed C1. In fact to do so will result in inconsistencies with the International Standards on Auditing (ISAs). For example, ISA 230 refers to the “auditor’s responsibility to prepare audit documentation”. The requirements are phrased as “the auditor shall”. Proposed Subsection 402 refers to the firm’s responsibilities. In the extant Code, section 290.29 in New Zealand refers to the assurance practitioner, and the extant IFAC Code refers to the professional accountant. The NZAuASB considers that the extant Code is clearer and more consistent with the ISAs.

The NZAuASB considers that a “firm” is the collection of all of the individuals that comprise the firm. Whilst the firm may ultimately be accountable for actions of the individuals it employs, the firm will have quality control procedures in place to ensure adherence to the firm’s policies. The individual is also responsible for their own actions. Disciplinary action taken by professional bodies is often against an individual and not the firm. The firm and the individuals that comprise the firm must work together to ensure compliance with the fundamental principles. The firm is not defined in a manner that is inclusive of all of the individuals that comprise the firm, rather the definition has a focus on the entity and therefore the NZAuASB does not consider that it is appropriate to use the terms interchangeably.

The use of “firm” is not consistent and in some instances the Code specifically refers to individuals. The NZAuASB considers generic reference to “firm” to refer to individuals could be clearer. For example, R510.4 is a new

requirement “A firm shall apply the conceptual framework set out in Section 120 to financial interests”. While the firm should apply the conceptual framework to any financial interests that the firm holds, in this instance, it is relevant for each individual on the engagement team to apply the conceptual framework to their own individual financial interests. The firm cannot dispose of an individual’s financial interest but may reassign the team member.

On the other hand, reference to the firm in R410.2 “A firm shall apply the conceptual framework to fees or other remuneration” appropriately refers to the firm’s responsibility. The NZAuASB considers it appropriate for the conceptual framework to refer to the “professional accountant” and for part C to refer to the firm.

The NZAuASB recommends that where appropriate, the Code should be written to be applied by both individuals on an engagement team and the firm, so as not to place the responsibility for compliance only with the firm. For those provisions where the responsibility lies with both the firm and individuals, the new requirements linking back to the conceptual framework should refer to all relevant parties, which the rest of those sections largely do.

(e) The clarity of language?

Response:

The NZAuASB is supportive of the direction of the proposals and considers that the draft is an improvement and will enhance the clarity of the Code. However, the NZAuASB still considers that the clarity and arrangement of C1 could be further improved.

The NZAuASB notes that the word “may” has been amended to “might” in some instances. The English dictionary highlights that might is the past tense of “may” and therefore the NZAuASB queries whether this change is appropriate. The NZAuASB prefers use of “may”. Where the IESBA is meaning that there is a possibility of something occurring, the word “could” may be more appropriate. The NZAuASB also queries whether the change from may to might, to indicate the possibility of something occurring as opposed to when something is permitted has been correctly made in all instances of the proposed change. In some instances, the NZAuASB considers that the proposed changes may be diluting the extant Code.

The need for an additional matrix as guidance is indicative that the Code is still challenging to understand. While the NZAuASB has not identified specific wording improvements, arranging the requirements by way of a table or matrix may make it simpler to comply with. On the other hand, these requirements are complex and maybe there is not one simpler drafting style that can cater for the complexities involved. The NZAuASB encourages the IESBA to develop a matrix summarising the types of financial relationships for different categories of individual and believes that this may be very helpful for practitioners.

The NZAuASB considers that the proposed shorter sentences, extra use of bullets and rearrangement of wording is all improving the clarity of the proposed Code but urges IESBA to pursue applying these drafting conventions throughout the proposals consistently and go even further to shorten and simplify the Code. For example:

1. There is some unnecessary repetition, for example:
 - a. 410.9 A2 repeats R410.8 and 9. Could this not be shortened?
 - b. Additional use of bullets could be added, for example R410.4 to separate out:
 - the public interest entity reference and
 - the 2 consecutive years fees of more than 15% elements.
 - c. The term “acceptable level” is defined in the glossary and then also described in section 120.6 A1. This is unnecessarily repetitive.
2. Where “an audit team member” is referred to twice in a sentence, could “they” be used instead? For example, 524.4 A1 “A self-interest threat is created when an audit team member participates in the audit engagement while knowing that they (the audit team member) will, or might, join the joint the client at some time in the future.”

The NZAuASB is supportive of the creation of and proposed additions to the glossary section and considers that this improves the clarity and readability of the Code and may help in the consistency of the use of terms. The NZAuASB recommends that the IESBA relocate the glossary at the front of the Code, possibly after the Guide to the Code.

The NZAuASB notes that there is a new defined term “engagement period” defined as “the engagement period starts when the audit team begins to perform audit services. The engagement period ends when the audit report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has terminated or the issuance of the final audit report.” It is not clear whether this term will be referred to in C2 on other assurance engagements in which case a different definition may be required. In addition, this definition may be inconsistent with ISA (NZ) 720 (Revised) which requires the auditor to read the “other information” even after the date the auditor’s report is issued. It may be more appropriate to define the engagement period for an audit to end once the auditor has issued the auditor’s report and met all of the requirements of the ISAs.

Reasonable and informed third party has also been added to the glossary. This is a helpful addition as this is referred to in a number of places.

(f) The navigability of the Code, including:

The NZAuASB is supportive of re-ordering of parts B and C. Having the independence sections at the end may be more user friendly as these form the bulk of the Code. However moving independence to the end may be misinterpreted as separating independence from the fundamental principles. This could be clarified by linking the fundamental principle of “objectivity” more closely to independence. The NZAuASB considers that the fundamental principles need to incorporate independence (within the principle of objectivity). Section C1 refers to “threats to independence”. This is inconsistent with the upfront sections that refer to the threats to the fundamental principles if independence is not seen as a fundamental principle.

(i) Numbering and layout of the sections;

Response:

The NZAuASB considers that indexing of the Code is important to assist with navigation and recommends that further improvements could be made. Colour coding the different sections may also be helpful. The NZAuASB considers that the numbering of the sections could be clearer and simplified. The section numbers mostly go up in 10s but for example section 320 covers Professional Appointment and Section 321 Second Opinions. Is section 321 a subsection of section 320 or a completely standalone section? It is entitled a section rather than a subsection? Whereas section 110 dealing with the fundamental principles is then broken down and labelled as subsections 111, 112, etc. 310 covers Conflicts of Interests and NOCLAR will be in section 315. Is there a reason why this is not 311? The use of these numbers could be clarified in the guide to the Code. The guide currently states that sections might have subsections dealing with specific aspects of the topic but the use of numbering may cause some confusion as to whether a section is a subsection or a standalone section.

The NZAuASB also considers that numbering the independence sections as C1 and C2 could be clearer. C1 and C2 are part of the section applicable to Professional Accountants in Public Practice (Part C), labelling them as C1 and C2 is not initially clear. It appears that the Independence sections are part of the code. However, the explanatory memorandum states that there was support for labelling and presenting independence sections as standards. The Preface also specifically states that the international independence standards are included in the Code. It is not clear whether the standards are to be separate or part of the Code and the NZAuASB recommends that this should be clarified. The NZAuASB would be supportive of having separate independence standards.

(ii) Suggestions for future electronic enhancements; and

Response:

The NZAuASB is supportive of an electronic Code to assist with navigation. It is not immediately clear from the exposure draft how the reorganisation will assist any electronic features and therefore have no comments to raise.

The NZAuASB considers that electronic functions may assist to further shorten the applicable code that an accountant needs to refer to. For example, if a professional accountant had to select a few options prior to accessing the code, including the type of engagement or work the accountant is performing, an electronic code could hide irrelevant sections and could use appropriate words for that context. For example, an assurance practitioner performing a review engagement: an electronic code could replace the word audit with the word review throughout extant section 290 and could hide extant section 291 as it is not relevant.

The NZAuASB was not supportive of splitting and repeating the independence sections when section 291 was created, noting that C2 is largely a repeat of C1, and that conceptually being independent in mind and appearance should not differ based on the type of assurance engagement. Another enhancement could eliminate the need for both C1 and C2. By selecting audit or review or other assurance engagement upfront, the duplication could be avoided and any irrelevant sections could be hidden.

(iii) Suggestions for future tools?

Response:

As highlighted above, the NZAuASB is supportive of the IESBA developing a matrix summarising the types of financial relationships for different categories of individual and believes that this may be very helpful for practitioners.

The enforceability of the Code?

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

Response:

The NZAuASB considers that appropriate restructuring will enhance both adoption and application of the Code. In New Zealand, the NZAuASB has already adopted but adapted the IFAC Code for application only by assurance practitioners, as this is what is within the legal mandate of the NZAuASB. As previously highlighted to the IESBA, the NZAuASB considers that the length of the existing Code is a barrier to accessing the relevant information and applying the fundamental principles. The general consensus is that “less is more” when establishing a strong principled based framework. That is the shorter the Code could be, the more accessible it becomes which could have a positive impact on application of the principles. The longer the Code, and the more complex and detailed rules it incorporates, the less likely there will be consistent application or adoption, as the requirements may either be inadvertently breached or ways to circumvent the rules will be created. While the proposed restructure is an improvement, the NZAuASB urges the IESBA to continue to seek ways to shorten and simplify the requirements with a focus on a strong principled based framework.

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.

Response:

The NZAuASB has not identified any concerns that the proposed restructuring would change the meaning of the extant Code.

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?

Response:

Absolute consistency in how terms are used is important to promote understanding and consistent application. The NZAuASB urges the IESBA to consider how users of the Code make use of the Code. A professional accountant is unlikely to read the Code from cover to cover but will refer to a specific paragraph of a section that is relevant to the ethical situation presenting itself.

The NZAuASB has not considered it appropriate to use the term “audit” to include “review” in the extant code in New Zealand and has amended all such references to refer to both audit and review. This was to avoid unintended breaches of the code where a practitioner refers only to one section and not the entire code. The NZAuASB considers that there is further reason to refer to both audit or review specifically given the recent proposals by the IESBA that distinguishes between audit and review in the NOCLAR section. The NZAuASB considers that it will be potentially confusing for one section of the Code to refer to audit to include review and another section to exclude it. The exposure draft has not been consistent in that in the table of contents the proposed list refers to Audit and Review in the title of C1 and section 402 but then just to an audit client in section 522, 523 and 524. All inconsistencies promote confusion and promote the risk of unintended breaches. The NZAuASB strongly recommends that references to “audit” should be amended to refer to “audit and review” in all instances where that is intended. Footnote 17 and reference to C1 in the glossary are not enough to clarify this inconsistent use of terminology.

In addition, the proposed clarification that audit include review is removed from the introduction to part C1 and added to the glossary. If this approach is retained additional emphasis should be given to this fact within the body of part C1.

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?

Response:

The NZAuASB is supportive of the proposals to distinguish firms and network firms, where relevant, i.e. that “network firm” be separately referred to and should be excluded from references to “firm” as in the extant Code. This will make it clearer where there are implications for the network firm. The NZAuASB considers that this proposal will result in consistent use of terminology and therefore is fully supportive of the change.

The NZAuASB has not identified any places where the reference to network firm has not been included where we consider that it should be.

Title

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

Response:

The IESBA is proposing to rename the restructured Code *International Code of Ethics Standards for Professional Accountants*. The NZAuASB considers that this is appropriate and does not detract from the principles-based approach.