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15 May 2017

Dear Mr Siong,

Exposure Draft – Improving the Structure of the Code of Ethics for Professional Accountants – Phase 2

The Financial Reporting Council (FRC) welcomes the opportunity to comment on the proposed improvements to the structure of the Code of Ethics for Professional Accountants (the Code) set out in the above exposure draft. The FRC supports the Board's aim to make revisions to the structure of the Code that are intended to enhance its understandability and usability, thereby facilitating its adoption, effective implementation, consistent application and enforcement.

Introduction

The Phase 2 ED addresses parts of the Code that were not covered in Phase 1, including the sections on NOCLAR, long association and Part C that have been subject to separate revision projects. It also reflects conclusions drawn by IESBA after considering the responses to the Phase 1 ED. In preparing our response, we have considered the explanations in the 'Basis for Agreement in Principle' for Phase 1 and the 'Basis for Conclusions' for NOCLAR, long association and Part C. We note that the Explanatory Memorandum includes the statement that "IESBA does not intend to make changes to the Phase 1 agreed-in-principle text unless required to ensure consistency with the final text of Phase 2 of the Structure project".

We have responded in the body of this letter to the specific questions asked by IESBA in this consultation. However, we also draw attention to a series of concerns outstanding from Phase 1, which we feel unless addressed, will mean that IESBA will not meet its aim to enhance understandability and usability of the code, and will prevent its effective implementation, consistent application and enforcement.

These concerns, raised in our response to the Phase 1 ED and the consultations on NOCLAR, long association and Part C are:

- Insufficient linkage between the fundamental principles and the detailed requirements
- The lack of clarity of the responsibilities of individual accountants and firms
- The lack clarity of some of the language
- Consequent difficulties for enforceability of the Code

In respect of the specific questions asked in the consultation we are supportive of IESBA's work to strengthen the Code. However, we have particular concerns in respect of:

- The examples included in the ED which in some cases are more akin to a rules rather than principles based approach to standard setting, and in others are for the most part very high level and insufficiently practical to support practitioners
- The lack of an overarching principle covering the preparation and presentation of information
- Cooling off periods for long association which are, in our view, insufficient to address the familiarity risk posed to independence.

Linkage between the fundamental principles and the detailed requirements

We have continuing concerns relating to the absence of clear linkage between the fundamental principles and the detailed requirements. We strongly believe that a principles-based approach, which clearly establishes overarching ethical principles and supporting ethical provisions, supplemented by clearly linked requirements addressing particular circumstances, will result in better ethical and behavioural outcomes. This was one of the primary drivers behind our recent revision of the FRC's Ethical Standard, which brings together the results of the FRC's own review of ethical matters and implements the requirements of the EU Audit Directive and Regulation.

Whilst we recognise that both the Guide to the Code and the revised structure do place greater emphasis on the fundamental principles and conceptual framework, we believe more should be done to clarify and emphasise the centrality of the fundamental principles in the conceptual framework, and establish an explicit linkage between the framework and the detailed requirements so that it is clearer how the requirements assist meeting the ethical outcomes. We do not believe this is achieved by simply repeating at the start of each Section that "professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats" and the subsequent short paragraphs that indicate which fundamental principles are threatened by the subject matter of the Section.

We found it necessary, and believe the IESBA should do likewise, to clarify the outcomes that are necessary to act in accordance with the fundamental principles by setting supporting ethical provisions. We also cross refer the supporting ethical provisions to the detailed requirements that help achieve them, providing more clarity as to the interrelationships.

There is a risk that by focusing on the requirements and application material presented in the Code, IESBA will drive a rules-based compliance mind-set rather than a principles-based focus on achieving appropriate ethical outcomes. In this respect, the Guide to the Code has a crucial role in providing users with a route map through the Code, and should contain more explanation of the purpose of the fundamental principles and the framework, as well as of the Code itself. This should emphasise the overall objective of achieving better ethical outcomes rather than simply following specific rules or establishing process. Under the heading 'How to use the Code' we again suggest the following alternative wording for paragraph 6:

> *"The Code requires professional accountants to comply with the fundamental principles of professional ethics. These principles, together with supporting ethical requirements and application material, have the objective of focusing on the achievement of ethical outcomes in all circumstances. This will represent a basis for users of services to have trust in the integrity and objectivity of the professional accountant."*

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The clarity of the responsibilities of individual accountants and firms

In our response to the Phase 1 ED, we identified that the senior management of the firm should have the overarching responsibility to ensure an appropriate ethical mind-set and culture. In our view, the clarity necessary to secure this is still lacking. We recommend that material is added in Section 120 to stress the fundamental importance of senior management in firms and other organisations taking an overarching responsibility to ensure that ethics and ethical outcomes are at the forefront of policies, procedures and culture within those entities. We also continue to believe further work is still needed to ensure that the Code is absolutely clear and unambiguous about who supporting requirements apply to.

In the Phase 1 'Basis for Agreement in Principle' IESBA identifies that some respondents had not supported the general use of the term 'firm' when responsibilities for compliance rests with individuals. However, many respondents did support "or accepted" the proposed use of the term 'firm' for ease of reference and IESBA reaffirmed its view that it is appropriate to continue on this basis. It is not clear how much explicit support there was for general use of the term 'firm' or whether some support is being assumed based on respondents being silent on the matter, but regardless it looks as though a decision has been made on the basis of numbers rather than reasoning.

IESBA states that it has sought to introduce greater clarity by providing an explanation of the approach in Section 120. We have reviewed the "agreed in principle text" of Section 120 and cannot see where this explanation is. We note that paragraph 400.4 of Section 400 (Applying the Conceptual Framework to Independence for Audits and Reviews) includes the explanation that:

> "…. The allocation of responsibilities within a firm will depend on its size, structure and organization. Many of the provisions of Part 4A [Independence for Audits and Reviews] do not prescribe the specific responsibility of individuals within the firm for actions related to independence, instead referring to "firm" for ease of reference. Firms assign responsibility for a particular action to an individual or a group of individuals (such as an audit team), in accordance with ISQC 1. In addition, individual professional accountants remain responsible for compliance with any provisions that apply to that accountant's activities, interests or relationships."

As both a standard setter and regulator, we take the view that clarity of responsibilities is essential to facilitate effective implementation, consistent application and enforcement. Using a general term "for ease of reference" prevents this clarity being achieved.

Clarity of language

Persons in a position of influence

In our response to the Phase 1 ED, we commented that, whilst we believe the current project has resulted in improvements to the clarity of language in the Code, we have concerns about the completeness and precision of some of the key terms being used. A particular issue we identified has not been addressed. Specifically, we believe it is inappropriate to define assurance, audit and review teams to include only individuals who are in a position to '***directly***' influence the outcome of an engagement. This creates a risk that an ability to influence is seen purely as a structural consideration (related to the position of an individual in a firm), whereas instead the assessment should be driven by a consideration that captures all of those who have the ability to influence and are relevant to the engagement.

Our response to the Safeguards Phase 2 ED also describes the related issue that the IAASB

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does not define "audit team" for the purpose of International Standards on Auditing (ISAs) but the IAASB (and IESBA) include "engagement team" as a defined term. The significant difference between the definitions of audit team and engagement team, and the fact that audit team is not an IAASB defined term, is unhelpful and risks inconsistent application of the terms, particularly by auditors who may be focussed on the definition of engagement team for the purpose of the ISAs.

'May' vs 'might'

The term 'may' is used, and defined in the Glossary, to "denote permission to take a particular action in certain circumstances, including as an exception to a requirement". The term 'might' is used, and defined in the Glossary, to "denote the possibility of a matter arising, an event occurring or a course of action being taken". We agree that this reflects some common language usage of those terms. However, this use of 'may' in the Code is inconsistent with its use in ISAs where it does not denote "permission" but rather actions auditors might take. It would be helpful if IESBA and the IAASB could be consistent in their use of terminology.

Audit includes review

The 'Basis for Agreement in Principle' for Phase 1 indicates that there was widespread support for the term 'audit' to be taken to include 'review' and therefore IESBA is keeping that position. We continue to believe this is inappropriate as, regardless of whether the ethical considerations are essentially the same, it is a simple fact that an audit is not a review. Recognising there had been some objection, IESBA notes that "adopting organisations, if they so wished, could choose to distinguish "audit" and "review" separately in their versions of the Code". However, advising that the Code can be modified, in effect to make it technically correct, does not encourage its adoption and risks inconsistencies arising that may affect its application and enforcement.

We struggle to understand IESBA's position as this is not an overly complicated matter to address. In the course of our revision of the FRC Ethical Standard we addressed a similar issue by referring generically to 'engagements' whilst being precise about the specific application to different types of engagement (whether audit or not) where they differed. Our standard is designed to apply to all engagements for which we issue performance standards (and so is broader in scope than audit and review engagements).

Defined terms

In connection with the discussion of 'audit includes review', the 'Basis for Agreement in Principle' for Phase 1 indicates that certain terms should be included in both the Glossary and the body of the Code; and that descriptions would be included in the body of Code when they first appeared rather than being denoted by footnote. This will only help understanding of those terms if someone referring to the Code starts at or before where the description is given – if they start later they may not appreciate that particular terms have a defined meaning. In our revised Ethical Standard we have addressed this by presenting defined terms in italics to alert readers that there is a defined meaning.

Enforceability of the Code

We support a principles based approach to ethics and, where appropriate, application of the threats and safeguards approach in the Code. However, we believe there are areas where the Code needs to be stronger in recognising that particular circumstances "will", rather than "might", create threats and that in some situations no safeguards will be capable of reducing the threats to an "acceptable level". This is particularly important if IESBA is to facilitate consistent application and enforcement of the Code. Please also refer to our response to the Safeguards

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Phase 2 ED which explains concerns we have with the use of "acceptable level"[1].

In our response to the Phase 1 ED we identified that, while there are sections in the Code in which it is stated that a circumstance or transaction creates a threat, there are numerous sections where the Code only states that a circumstance or transaction "might" create a threat. We remain concerned that there is still insufficient presumption in some sections that a threat is created by particular circumstances which must be evaluated and (when appropriate or possible) safeguards applied. For example, paragraphs 340.2, 340.4.A1 and 420.1 indicate that an offer of gifts or hospitality from a client, or accepting gifts or hospitality from an audit client, might create self-interest, familiarity or other threats. We believe the presumption should be that "accepting gifts or hospitality creates self-interest and familiarity threats".

We have a similar concern in relation to Section 411, which addresses compensation and evaluation policies, that has only been partly resolved by adopting very generic wording, rather than describing a specific circumstance, that "a firm's evaluation or compensation policies might create self-interest threats". Section 411 recognises (paragraph 411.4.A1) that self-interest threats arise when an audit team member for a particular audit is evaluated on or compensated for selling non-assurance services to that audit client. However, the requirement in paragraph R411.5 to preclude evaluating or compensating someone on this basis applies only a key audit partner and not to other members of the audit team. IESBA takes a position that evaluation and compensation on the basis of selling non-audit services to an audit client is acceptable for an audit team member, other than a key audit partner, if a safeguard is applied such as "having a professional accountant review the work of audit team member". We believe this is a weak position for IESBA to take, and risks firms establishing policies that a regulator (and other stakeholders) would consider inappropriate.

By contrast, the EU Audit Directive requires that "the amount of revenue that the statutory auditor or the audit firm derives from providing non-audit services to the audited entity shall not form part of the performance evaluation and remuneration of any person involved in, or able to influence the carrying out of, the audit". The Directive requirement is reflected in our Ethical Standard and we strongly recommend that IESBA should conform to the EU position. If IESBA does not do this it should at least stipulate that the professional accountant undertaking the review should be independent of the audit team and, importantly, that the level of threat should be reduced to one where an objective, reasonable and informed third party would not consider the independence of the audit team member to be compromised.

Responses to the IESBA request for specific comments

Structure of the Code Phase 2

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**

[1] https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/FRC-Response-to-IESBA's-Consultation-on-Safeguards.pdf

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4B in Chapter 5)?

If so, please explain why and suggest alternative wording.

We are not concerned that the restructuring of the Code has introduced unintended changes of meaning, but rather that IESBA is not finalising the Code in a way that addresses significant concerns we, and others, have previously expressed in relation to some of these areas. As a consequence, in our view, IESBA will not achieve its aim to enhance understandability and usability of the Code to facilitate its effective implementation, consistent application and enforcement. General concerns relating to structure and language are described above. We set out more specific concerns in relation to Part C, NOCLAR and long association in our responses to the IESBA EDs on those and are disappointed to find that many have not been satisfactorily addressed. We reiterate below some of those concerns that we believe are fundamental to the understandability and usability of the Code.

Part C

Section 220 - Preparing and presenting information

In our separate response to the Safeguards Phase 2 ED, we noted that we strongly believe that a principles-based approach, which clearly establishes overarching ethical principles and supporting ethical provisions, supplemented by clearly linked requirements addressing particular circumstances, will result in better ethical and behavioural outcomes. Consistent with this, we recommend that there should be an overarching principle for the preparation and presentation of information along the lines of:

> "In performing any professional activity that is involved with the preparation or presentation of the employing organisation's information, the professional accountant shall do so in accordance with the fundamental principles. The objective is to ensure that the information, insofar as the professional accountant is able to influence it, is fair, balanced and understandable and can be trusted by the intended users given the intended purpose and context of its use."

The fundamental principle of professional competence and due care should apply in all regards and, therefore, for example, unintentionally preparing and presenting information that is misleading (including information that is inappropriately influential) should be as much of a concern as should preparing and presenting information that is not in accordance with a relevant reporting framework whether intentionally or unintentionally. In the second bullet point of paragraph 220.7.A1 it should be clearer that, to comply with the fundamental principle of competence and due care, a professional accountant should prepare and present information that is not misleading (i.e. it is more than just not intending to mislead).

Further, the specific reference to 'nor to influence contractual or regulatory outcomes inappropriately' may appear to unnecessarily restrict the meaning of 'mislead', which we believe should encompass intent to inappropriately influence outcomes. We recommend indicating that complying with the fundamental principles includes "preparing or presenting information that neither misleads nor is intended to mislead (including by inappropriately influencing regulatory, contractual or other outcomes based on the information)". Similarly the third bullet point should be amended to "Not omitting information with the intention or effect of rendering the information misleading".

Information that does not have to comply with a relevant reporting framework

The requirement in paragraph R220.9 and supporting guidance in paragraphs 220.9.A1 and A2 is very limited and is not clearly presented as relating specifically to circumstances where there is not a relevant reporting framework. We believe the factors identified here are of more general

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application and suggest that they should support the overarching principle recommended above. The guidance should clarify that the overarching principle also applies where there is no relevant reporting framework. It should be clear that the professional accountant ensures sufficient relevant information is given to enable the intended users to have a reasonable understanding of the information that is relevant to their needs, in particular in relation to matters of judgment and estimation and the assumptions underpinning them. The nature and extent of such information may depend on a number of factors, including: the context in which the information is presented; its purpose; the intended users; and whether and to what extent there is an applicable financial reporting framework and/or other criteria affecting the information.

Reliance on the work of others

We believe that referring to a professional accountant relying on the work of others suggests an active choice by the professional accountant. It would be more appropriate to refer to circumstances where the outcome of the professional accountant's work is dependent on the involvement of others in the preparation or presentation of the information.

IESBA has amended the requirement that is now presented in paragraph R220.10 so that the professional accountant exercises "professional judgment to determine what steps to take, if any, in order to fulfil the responsibilities set out in paragraph 220.7.A1" rather than being required to take "reasonable steps" to be satisfied that such work [being relied on] enables the professional accountant to fulfil those responsibilities. This was in part to avoid giving detailed guidance as what might be "reasonable steps". However, the supporting guidance in paragraph 220.10.A1 refers to "Factors to consider in determining whether reliance is reasonable include". To better align with the updated wording in the requirement this could be changed to "Factors to consider in exercising this judgment include".

The factors actually given in paragraph 220.10.A1 are limited, very high level and unlikely to give much practical help. While we agree IESBA should not attempt to give detailed guidance that covers a wide range of circumstances, we believe it could give some more practical guidance. For example it could indicate that:

> In large organisations/groups, the outcome of the professional accountant's work may in practice depend on the work of others, or on the effective operation of internal controls over that work that are the responsibility of others, who may be far removed from them in the chain of involvement in the preparation or presentation of the information. For example, others with significant involvement could be based in a service centre in another part of the world.
>
> In these circumstances, a professional accountant who is relatively junior in the employing organisation, may consider factors including whether there are internal manuals that can be consulted and making appropriate inquiries to enable them to consider whether the work of those close to them in the chain of involvement (in preparation or presentation) is significant to the outcome and has been performed in a manner consistent with the principles in this section (and whether they are aware of any evidence that it has not been).
>
> For a more senior professional accountant, factors to consider may include the work of others more distant in the chain of involvement, and obtaining an understanding of the outcomes of tests by others, of controls over that work (e.g. by internal auditors). However, the professional accountant should not be expected to always undertake such tests themselves.

This is an example of an area where different guidance can be helpful depending on the seniority of the professional accountant. In the 'Basis for Conclusions' IESBA noted that it considered that "there are logical grounds for such differentiation in the NOCLAR proposals in that an act of

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NOCLAR is a matter that could have significant public interest implications. This therefore gives rise to expectations of an appropriate response, the nature and extent of which will depend particularly on the seniority of the PAIB. IESBA determined that such a distinction would not be suitable for guidance in other areas addressed by the extant Part C." To suggest that for areas other than NOCLAR such a distinction would "not be suitable" seems odd. The rationale is more clearly explained as IESBA goes on to note that "Given the variety of situations in which PAIBs are employed, including the variety of organizational structures that exist, IESBA agreed that clearly separating responsibilities according to seniority in those two sections would not be practicable. IESBA also reviewed all the examples provided and determined that the guidance in the two sections would be useful to PAIBs at any level in an employing organization." However, as our comments illustrate, there can be areas where guidance which distinguishes between senior and junior accountants could be helpful, particularly having regard to the possible differences in levels of authority and ability to take particular actions.

Disassociation with misleading information

Paragraph R220.13 requires that "If after exhausting all feasible options, the professional accountant determines that appropriate action has not been taken and there is reason to believe that the information is still misleading, the accountant shall refuse to be or to remain associated with the information." If it has not been possible to get misleading information corrected the professional accountant should seek to be disassociated from that information. However, association is a matter of both fact and perception. It may not, therefore, be possible for a professional accountant to refuse to be or to remain associated with the information. Association with the information might remain even if the accountant were to resign from the organisation, which is suggested as a possible action in paragraph 220.13.A2. If the professional accountant considers resigning, regard is given to seriousness of the matter and whether the public interest benefits of resigning would reasonably be expected to outweigh any adverse consequences of doing so.

The last part of paragraph 220.11.A1 cross refers to Section 260 for a situation where misleading information might involve non-compliance with laws and regulations. The guidance should more explicitly address considerations as to whether the professional accountant has reason to believe the information is intentionally misleading.

Section 270 - Pressure to breach the fundamental principles

We believe that the list of illustrative examples of pressure in paragraph 270.4.A2 is unnecessarily detailed and risks supporting a rules based, rather than principles based mind-set. Some of the potential pressures identified relate to matters that in many jurisdictions would constitute fraud or other illegal acts – it is not helpful to mix ethical considerations with legal considerations. We would expect a professional accountant to be aware when they are under inappropriate or undue pressure, and that in no circumstances should they knowingly breach relevant laws and regulations. The guidance in this section should be focussed on the considerations when the professional accountant is being subjected to such pressure.

NOCLAR

There remains considerable variation in the requirements and guidance for different categories of professional accountant. We agree that the approaches need to take into account the differing roles, levels of seniority and spheres of influence of professional accountants. However, the differentiations should be based primarily on the expected level of understanding of laws and regulations that may be relevant to the scope of their responsibilities and their ability to investigate further and take action - this is not always clearly the case. For all professional accountants there should be clear up-front overarching ethical principles:

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- Not to be associated with a client or employing organisation that knowingly does not comply with applicable laws and regulations and lacks integrity, unless disassociation is prevented by law or regulation.
- To be satisfied that, where possible and appropriate, disclosure of actual or suspected non-compliance is made to an appropriate authority that is able to take action.

Establishing such principles would help focus on achieving appropriate ethical outcomes in the public interest, and not just compliance with particular requirements. We note that in the 'Basis for Conclusions', IESBA specifically refers to this recommendation (which we gave in our response to the NOCLAR ED) and states that "The Board did not accept these suggested objectives as they are much narrower in focus [than the objectives that had been proposed in the ED]. Further the focus on disassociation and the possibility of disclosure to an appropriate authority was already covered in the ED". We did not suggest that these be the sole objectives of professional accountants, so their dismissal on the grounds of narrow focus is not appropriate; and while disassociation and the possibility of disclosure to an appropriate authority are covered it is not in a way that clearly establishes an objective to achieve the ethical outcomes as we have expressed them. As currently structured, there are in fact no clear 'objectives' that reflect the appropriate ethical outcomes specific to the different Section subject matters, just the repeated requirement to comply with the fundamental principles and apply the conceptual framework. As we discuss above, this approach fails to clarify the ethical outcomes that are necessary to act in accordance with the fundamental principles.

Reporting to an appropriate authority

Significant variation exists in relation to reporting actual or suspected NOCLAR to an appropriate authority. We believe that there should be a requirement for all professional accountants who identify actual or suspected non-compliance with laws and regulations [in the course of their work], to determine whether they have a responsibility to report the matter to an appropriate authority. This would reflect a general ethical responsibility to act in the public interest and assist in preventing professional accountants from themselves committing an offence by failing to make a report when there is a legal or regulatory requirement to do so. For example, under the UK Proceeds of Crime Act 2002 there are reporting requirements in relation to known or suspected money laundering that are applicable to all persons working in a 'regulated sector', and failure to make such a report when appropriate is itself an offence.

Of particular concern is the requirement in paragraph R260.26 for professional accountants in business who are not 'senior professional accountants'. This suggests that a requirement to report will arise only "in exceptional circumstances", as the rest of this subsection is based on the premise that the normal method of addressing a concern is to report to a more senior person within the entity. This risks leading such professional accountants to fail to understand legal or regulatory requirements that may apply, and end up in breach of them. This is avoided if, as we recommend, all professional accountants are required to determine whether they have a duty to report - if they do not, then it may be appropriate to see the matter escalated up the chain of authority rather than making a report themselves.

When determining action to be taken, paragraph R360.21 requires "... the accountant shall take into account whether a reasonable and informed third party would be likely to conclude that the accountant has acted appropriately in the public interest." However, we remain concerned that some guidance may discourage making a report in the public interest when it would be appropriate do so. For example, in the later subsection that addresses "determining whether to disclose the matter to an appropriate authority", paragraph 360.25.A3 still states that "the determination of whether to make such a disclosure will also depend on external factors such as: ....whether there exists robust and credible protection from civil, criminal or professional liability or retaliation afforded by legislation or regulation, such as under whistle-blowing

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legislation or regulation." We believe this may lead a professional accountant not to make disclosure in circumstances where it would be appropriate to do so. In many jurisdictions there may not be explicit "robust" legal or regulatory protection, but it may be generally established that a professional accountant would not be held in breach of a duty of confidentiality if he/she could demonstrate that they acted reasonably and in good faith. We recommend that this point is amended to indicate that if the professional accountant is concerned about whether he/she would be open to action in the courts as a result of making a disclosure, they should obtain legal advice.

Scope of laws and regulations

In our response to the NOCLAR ED we identified that the scope of these sections is too narrowly restricted to laws and regulations that either have a direct effect on financial statements, or with which compliance may be fundamental to the operating aspects of the business. It specifically excludes personal misconduct unrelated to the business activities of the client and non-compliance by persons other than the client, those charged with governance, management or employees of the client. In the 'Basis for Conclusions' it is stated that "The Board noted that placing no limitation on the scope of laws and regulations covered would lead to an undue burden being placed on PAs, over and above what it would be reasonable to expect them to respond to by virtue of their professional training and expertise. The Board reaffirmed its view that it should be a personal responsibility for PAs to determine whether and how they should respond to NOCLAR outside the scope of laws and regulations covered by the sections."

We are very concerned that IESBA does not address this with sufficient regard to the public interest. From an ethical perspective, all professional accountants should be required to respond appropriately when they identify matters that they know or suspect to be non-compliance with any laws and regulations, not just laws and regulations related to the preparation of financial statements or fundamental to the operating aspects of the business. We believe that this would be the expectation of 'the public' and essential to compliance with the fundamental principles of integrity and professional behaviour. There is no requirement, or suggestion, that professional accountants should necessarily have knowledge of law and regulations beyond that gained by virtue of their professional training or expertise, so it is wrong to claim that "placing no limitation on the scope of laws and regulations covered would lead to an undue burden". Some professional accountants will have an understanding of law and regulations outside that of IESBA's current proposed scope and failing to respond appropriately to a known or suspected breach of those laws or regulations cannot be excused from an ethical perspective and would fail to serve the public interest.

Determining whether further action is needed

Although there are requirements to "determine if further action is needed in the public interest", we remain concerned that the supporting guidance fails to give sufficient consideration of what action would be appropriate in the public interest and that the determination should be made on the basis of what an objective, reasonable and informed third party would be likely to conclude given the information known at the time. For example, the threshold in paragraphs 260.17.A2 and 360.20.A1 of "credible evidence of actual or potential substantial harm" is open to widely differing interpretation and may not meet the third party test as to what is in the 'public interest'. This will not help enhance understandability and usability of the Code, nor facilitate its consistent application and enforcement.

Reporting a matter to a network firm

IESBA has maintained its proposal that a professional accountant performing a non-audit service for an audit client of a network firm "consider whether to communicate the matter to the network firm" rather than requiring communication as is the case where the service is being

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performed for an audit client of the same firm. In the Basis for Conclusions IESBA repeats that it believes this is necessary as the position with respect to communication to a network firm may be "more complex and nuanced". We believe that this is not giving sufficient regard to what is in the public interest. The guidance in paragraph 360.34.A1, which lists factors relevant to considering whether to communicate, includes "The likely materiality of the matter to the audit of the client's financial statements or, where the matter relates to a component of a group, its likely materiality to the audit of the group financial statements." Considering materiality to the financial statements may lead to an inappropriate conclusion as to what is in the public interest. Unless prevented by law or regulation or contractual obligations there should be a requirement to communicate.

Long association

We are pleased that there is no longer a difference in requirements between listed and non-listed PIEs.

We note that the jurisdictional safeguards (that would have allowed for a reduction in the cooling off period) have been simplified but we are concerned that IESBA still allows for a transitional period (to 15 December 2023) where a national regulator can override the Code and establish a shorter cooling-off period for engagement partners. As we explained in our response to the limited re-exposure ED, if IESBA has determined what it believes is the appropriate cooling-off period required (we support five years) it should not compromise its position – this undermines the Code. A reduction in the cooling-off period can only be acceptable where there is a legal or regulatory requirement mandating such. However, we agree that to introduce such a change with effect for audits of periods beginning on or after 15 December 2018 could be problematic. The proposed effective date for the other parts of the restructured Code for audits of financial statements for periods beginning on or after 15 June 2019 should, however, provide sufficient time for auditors and their clients to prepare for the new requirements.

We are disappointed that, while the requirements for establishing the cooling-off period for a partner who has served in a combination of roles have been simplified, IESBA has rejected our recommendation that a partner who has served the maximum permitted time-on period, including as the engagement partner, EQCR or combination of those roles should be required to cool-off for the full five year period. IESBA's rationale is that our recommendation "would fail to recognise situations such as where the individual acted as the substitute EP or EQCR for just one year while the incumbent EP or EQCR took, for example, maternity leave, resulting in a disproportionate outcome." However, if a partner took a full year out (i.e. did not serve as EP or EQCR at all in relation to one full engagement period) we would not include that year in determining the time-on period. For a partner undertaking a combination of roles the familiarity threat is increased with an increasing period of time, whatever the role.

Restricted use reports

Sections 800 (for audits and reviews) and 999 (for other assurance engagements) set out conditional modifications, including exceptions, from particular independence requirements. These are permitted in certain circumstances for engagements where the report includes a restriction on its use and distribution. We believe such modifications are appropriate where all parties are knowledgeable of the circumstances and there may, for example, be less perception risk. However, we suggest that there could be explicit emphasis in the introduction to these sections of the need to comply with the fundamental principles of integrity and objectivity.

Independence for other assurance engagements

As we acknowledge above, a case may be made for less stringent requirements applying to private reporting engagements, where all parties are knowledgeable of the circumstances and

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there may, for example, be less perception risk. However, we consider the independence considerations for public interest assurance engagements are the same as those for audit engagements. When we revised our Ethical Standard we developed it to apply to audit and other "public interest assurance engagements" and we recommend IESBA takes the same approach. This would eliminate unjustifiable inconsistencies and also enable the Code to be shortened.

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?**

We agree the proposals are consistent with the first 3 bullet points in paragraph 13 of Section III of the Explanatory Memorandum. However, while there are improvements in clarity compared to the extant Code, we believe there is more to be done to improve clarity including, in particular in relation to the responsibilities of firms and individuals (see our comments above).

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.**

Please refer to our response to the Safeguards ED-2[1], where we comment on the conforming amendments to Chapter 2. Similar observations apply to the safeguards text that is presented in the Structure Phase 2 ED. In particular we would emphasise that it should be made clear in the requirements that threats are to be eliminated or reduced "to a level at which the fundamental principles would not be compromised". This would help ensure that the professional accountant focuses on ensuring that threats are eliminated or reduced to a level where the third party test would be passed. We believe this (implicit) link to the third party test would accord with the expectations of stakeholders, support their confidence in the professional accountant, and be more likely to anchor the professional accountant to those expectations when evaluating threats and safeguards.

Effective Date

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

Subject to our comments above regarding the transitional period for the cooling-off requirement, if IESBA achieves its aim to complete the restructuring of the Code in December 2017, we believe the proposed effective dates are acceptable.

If you have any questions on our response, or wish to discuss any of our observations in more detail please contact Mark Babington, Deputy Director of Audit Policy on m.babington@frc.org.uk or +44-20-7492-2323.

Yours sincerely,

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