

23 May 2017

Mr. Ken Siong
Technical Director
International Ethics Standards Board
for Accountants
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submitted electronically through the IESBA website

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Re.: Improving the Structure of the Code of Ethics for Professional Accountants – Phase 2

Dear Mr. Siong,

The IDW appreciates the opportunity to comment on the above mentioned Exposure Draft and proposed changes to the Code of Ethics for Professional Accountants hereinafter referred to as “the ED” and “the Code”, respectively. We submit general comments in this letter and then respond to the questions raised within the IESBA’s request for comments in the attached appendix.

Support for the IESBA’s Restructuring Initiative

We continue to support the proposed restructuring of the Code.

As we stated in our previous letter of 18 April, 2016 concerning phase 1 of this project, we basically agree with the approach IESBA has taken to restructuring the Code. However, we continue to believe that ease of navigation could be improved further if certain changes were made to some Subsections, including the use of objectives and the use of additional cross referencing rather than repetition.

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

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Need for a Pre-Finalization Review for Consistency Purposes

Given the volume of material, and the complex interaction of this project with other ongoing IESBA projects, the proposed restructuring of the Code has been progressed in a relatively short period of time. The Board and particularly IESBA staff are to be commended in this respect.

In terms of drafting style it is evident that different individuals “held the pen” in regard to specific Sections of the Code. In addition, because the Board has been tasked with fitting material from the extant Code into a restructured format, for which it was not originally developed, there are inconsistencies and gaps in some areas. Whilst we comment on a few such matters in the appendix to this letter, we believe a pre-finalization “consistency check” will be needed. Such an exercise may also reveal the need for the Board to address issues such as inconsistent coverage in a later stage project.

Challenges to Parties Seeking to Comment

The project’s division into two phases combined with the necessity for IESBA to work in parallel with several other ongoing projects has resulted in extreme difficulties for potential commenters wishing to orientate themselves. Indeed, without reference to the “Compilation of the proposed restructured Code” and “Basis for Agreement in Principle: Structure Phase 1” released in January 2017, review of the material issued in phase 2 would have been even more challenging, in regard to determining where the Sections and Subsections in this ED are to fit into the Code.

Going forward, an overly complex approach to projects should be avoided wherever possible. We would strongly encourage the IESBA to bear in mind the capacities and resources within the community of interested parties who may wish to comment on papers such as this ED.

Objectives to Support Requirements

We agree that, on the whole, a clear delineation between actions that are both required and prohibited (requirements) from supporting text (application material) throughout the Code has been achieved.

However, we are concerned that the IESBA did not take up the suggestion we had made in commenting on phase 1 in regard to the inclusion of “overarching objectives” to support requirements. We refer to pages 2 and 3 of our letter to the IESBA dated 18 April, 2016 in this context.

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In this context, we note that paragraph 11 of the “Basis for Agreement in Principle: Structure Phase 1” refers to overarching requirements and specific requirements, implying that IESBA supports the *concept* of an overarching objective, if not the terminology. Indeed, in reviewing the ED we noted that certain requirements (i.e., those that are in nature overarching) read more like objectives and that there are also instances of application material containing the phrase “objectives”. We refer to our response to question 2 in the appendix to this letter in respect to the latter. If IESBA does not act upon our suggestion to use the term “objective” for what the Board refers to as an overarching requirement, we believe it will be necessary to ensure consistent use of terminology throughout the Code.

Significance of the Criterion “Reasonable Level” in Applying the Threats and Safeguards Approach

Paragraph 120.2 contains key information (underlined below for identification purposes) supporting the overarching threefold requirement pertaining to threats to compliance with the Code’s fundamental principles:

- (a) Identify threats to compliance with the fundamental principles;
- (b) Evaluate the threats identified; and
- (c) Address the threats by eliminating or reducing them to an acceptable level.

Sections 1, 2 and 3 (and R400.12, and R900.16 specific to independence) each contain an overarching requirement governing their respective subsequent Sub-sections that summarizes these steps, but does not allude to the necessity to apply the criterion “acceptable level” in complying with this requirement:

- **R120.3** The professional accountant shall apply the conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles set out in Section 110.
- **R200.5** A professional accountant shall comply with the fundamental principles set out in Section 110 and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to compliance with the fundamental principles.
- **R300.4** A professional accountant shall comply with the fundamental principles set out in Section 110 and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to compliance with the fundamental principles.

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The explanation that the terms “evaluating” and “addressing” apply a criterion of “acceptable level” only really becomes clear from the requirements in R120.7 and R120.10 respectively.

In our view, because of the significance of the criterion “acceptable level” to the application of the threats and safeguards approach, the Code needs to be far clearer and consistent in this regard. Our review of the ED revealed that although Sections 2 and 3 are clear as to the overarching requirement, coverage of the supporting requirements and application material is lacking or inconsistent. We appreciate that inconsistency is inevitable because this material results from the restructuring of extant text, which was not developed specifically for this purpose.

Taking just Sections 2 and 3 as an example, we note that the accompanying application material in Section 2 covers *identifying* threats (200.6 A1) and *evaluating* threats (200.6 A2-A4), but lacks material specific to *addressing* threats. In Section 3, application material in 300.6, 300.7 and 300.8 deal with identifying, evaluating and addressing threats respectively; however the need to apply the criterion “acceptable level” is not clarified. As a minimum, and since it is key to the application of the Code’s threats and safeguards approach, we believe that the overarching requirements repeated in each key Section of the Code need to be expanded to clarify this aspect. In addition, consistent treatment would be helpful in this context in each of Sections 2 and 3.

In our view, a follow-on project may be needed to identify and deal with any such “gaps” in the restructured Code.

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

Yours truly,

Klaus-Peter Feld
Executive Director

Helmut Klaas
Director European Affairs

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Appendix

Request for Specific Comments

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.

We comment as follows:

1.1 Proposed Revisions that Obscure Clarity of Wording in the Extant Code

We note a few instances in the ED where the original text was clearer or more precise than the proposed revised wording and where proposed changes impact the meaning:

Provisions addressing long association:

- We appreciate that the IESBA is moving away from the approach that considers the relative significance of threats to an approach to eliminate or reduce threats to an acceptable level. However, we question why the following changes are proposed to R540.5: “If a firm decides that the level of the threats are so significant that created ...” without reference to this level not being at an acceptable level – i.e., so as to retain the reference to the “degree of significance”. This applies also in respect of further paragraphs, e.g. 540.5 A1 and A2, 540.4 A3 as well as R940.5 and 940.5 A1 and A2 and 940.4 A3. The original text consistently referred to significance of the threat and so was far clearer in regard to the fact that only threats above a certain threshold (i.e., not at an acceptable level) are to be addressed. The covering letter also questions

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the need for consistent clarification of the application of “acceptable level” as a key criterion in applying the threats and safeguards approach, suggesting this be addressed within this project. Depending on how the IESBA decides to address this, changes along the following lines could be made: R540.5 could read: “If a firm decides that the level of the threats created exceeds an acceptable level and can only be addressed by...” or R540.5: “If a firm decides that the level of the threats created is so high that it can only be addressed by...”.

- In proposed 540.19 A1 the term “senior or managing partner” has been replaced with “chief executive or equivalent”. This may be less readily understood in some jurisdictions, particularly on translation.

Independence Standards

- Extant 290.508 states: “... the relevant provisions ... apply only to the members of the engagement team, their immediate family members and close family members”. The limitation on application is precise. In contrast, the proposed requirement R800.9 (a) amends this to read: “... need only apply to ...”. This revised text could be interpreted as setting a minimum, but it may also imply that application is not necessarily limited to the persons listed. There are other instances where the phrase “... does not need to ...” is proposed (see R800.7, R800.9, and R999.7), going beyond the extant corresponding wording. We suggest the word “need” be deleted in each such instance.
- Although derived from 291.118 of the extant Code, proposed R290.5 excludes members of the immediate family of an engagement team member.

1.2 Hidden Requirements

There are certain instances where draft application material appears to contain a requirement. Clarification is needed in the following instances:

- The wording of 210.8 A1 might imply a hidden requirement because it states “It is generally necessary ...”, as such the authority attaching to this text is not sufficiently clear. IESBA should clarify the authority (i.e., can a safeguard be deemed effective or ineffective if full disclosure is not made to, and consent obtained from, the relevant parties in one of the various ways outlined in 210.8 A2?). Following this necessary clarification appropriate revision of this wording is also needed.
- 220.7 A1 states that a requirement “... includes...”, which implies the list of inclusions are themselves requirements and so not appropriately

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placed within application material. In this context, we also note that 220.10 refers to fulfilling responsibilities. It is unclear whether this terminology is intended to imply a requirement (do “responsibilities” equate to requirements?). Consistent terminology would be helpful.

- 220.10 A1 should read “factors to that might be considered”, otherwise there is an implication that these factors will always have to be considered and thus constitute requirements.
- 260.7 A1 uses the construct “when responding to ... the objectives of the professional accountant are: ...”. This implies required behavior and mirrors requirements in this Section. We also refer to our cover letter in this context. This notwithstanding, the authority of material denoted as an objective in the application material is unclear. We do not support its inclusion in application material, since such terminology, so placed, introduces confusion as to the authority. On balance we suggest IESBA place this material in a Subsection dealing with an overall objective. Note: 360.21 A2 also refers to achievement of the professional accountant’s objectives.
- The second sentence of 200.9 A1 states: “In these cases, if matters are communicated with person(s) with management responsibilities, and those persons also have governance responsibilities, the matters do not need to be communicated again with those same persons in their governance role.” This is a clarification of a requirement that itself constitutes a negative requirement. There are similar negative requirements clearly shown as requirements elsewhere in the restructured Code (see R800.7, R800.8). We suggest this text be moved and placed within a requirements paragraph.
- Use of the present tense in application material should be avoided, as its use makes the authority of text unclear. There is considerable inconsistency in the drafting of application material. Use of the present tense such as “Matters to consider include ...” (see 220.10 A1, 260.16 A1, 360.11 A2, 360.19 A1, 360.30A2, 360.34 A1, 360.36 A3 etc.) implies a non-exhaustive list of matters which are to be considered in all cases (i.e., implies a requirement). In similar instances the proposed text reads “the professional accountant might consider ...”, which is clear. We suggest the application material be drafted consistently avoiding use of the present tense.

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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 comment on each of the five key elements of the restructuring as described in Section III of the Explanatory Memorandum in turn:

- 2.1 *Increased prominence of the requirement to comply with the fundamental principles and apply the conceptual framework:*

Repeated Reference to Overall Requirement

In response to the ED Phase 1 of this project, we have previously questioned the proposal to repeat the sentence “Professional accountants are required to comply with the fundamental principles and apply the conceptual framework ... to identify, evaluate and address threats” in the first paragraph of the introduction to each individual Section. Reading the “Compilation of the proposed restructured Code” it becomes clear that this overriding requirement is repeated in the lead in to each major chapter (i.e., R120. 3, R200.5, R300.4, R400.12, and R900.16). Repetition in each of the subsequent Subsections lengthens the Code and – other than acting as a reminder of the overall purpose of the Code and the overarching requirement, does not add value.

- 2.2 *Requirements – identification and differentiation from other material:*

Use of the Terms “Expectations” and “Encouraged to”

We note several instances where application material refers to “expectations” of professional accountants. Notwithstanding the placement of such text in application material, the use of such terminology does mean that the authority of this text may be less clear than is desirable in the restructured Code.

For example, the second sentence of proposed 200.5 A3 implies that any professional accountant in a suitably senior position in an organization ought to live up to the expectation and thus encourage and promote an ethics-based culture. The extent of such an implicit requirement remains unclear. As a minimum it could be a requirement applicable to all professional accountants not to discourage/ play down such a culture; as a maximum it could be a requirement – conditional on the professional accountant holding a suitably senior position – to actively encourage and promote this (this may be problematic to the extent that taking any necessary concrete measures may not be in the remit of the role assigned to that individual). Paragraph 20 of ISQC 1 establishes requirements for the firm in this context.

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Further examples of expectations include: 260.12 A1, 260.24 A1, 360.10 A2, 360.29 A1, 905.6 A1.

We also note instances where “professional accountants are encouraged to ...” In many cases the term “encouragement” is used in relation to documentation. However, in regard to documentation, we note that throughout the ED there are also other scenarios where documentation is not mentioned (e.g. relating to independence), and yet others where specific documentation is required. Whilst it may thus be clear that encouragement to document is not intended to equate to a requirement, we are concerned that where such guidance is specifically provided this could be perceived as representing best practice and thus be perceived as a de facto requirement. Some reference to the exercise of professional judgement or as to when such encouraged action might be particularly appropriate and when not would be helpful.

We note the use of encourage in: 210.8 A3, 210.9 A1, 220.13 A2, 270.5 A1, 260.23 A1, 260.27 A1, 360.40 A1.

2.3 Application material – identification and positioning

There are two key issues included in the application material that, in our view, ought to be far more prominent:

Legal Prohibitions

260.20 A1 refers to the existence of legal prohibitions in some jurisdictions (e.g., Germany) that preclude reporting of NOCLAR to external parties. The significance of this text to professional accountants who are affected is such that it needs to be far more prominent. This should therefore be placed within the relevant requirements (R260.21 and R360.26).

Inconsequential Matters

Proposed Part 2 includes a reference to clearly inconsequential matters in para 260.7 A3, and is thus limited to the NOCLAR Section. This important clarification ought not to be limited to the Section on NOCLAR alone, but be extended to all circumstances giving rise to potential threat covered by the Code, since a clearly inconsequential matter can per se generally not be deemed to threaten – above an acceptable level – compliance with a fundamental principle anywhere in the Code. The IESBA should revisit the relevance of the term “clearly inconsequential” to the Code as a whole, and its interaction with identification and/or evaluation of threats at an acceptable level.

In many instances, the fact a professional accountant is faced with a clearly inconsequential matter will mean that – in relation to that matter – in practical

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terms, the professional accountant will not need to comply with the relevant requirements of the Code.

I.e., a matter that is “clearly inconsequential” can, by its very nature, be a limiting factor as far as the applicability of the Code is concerned.

If the IESBA believes that there are circumstances where this can never be the case, these could be addressed individually.

2.4 Increased clarity of responsibilities:

We appreciate the fact that the IESBA has decided to clarify which parties have certain particular responsibilities. The Code is, however, designed for application by individuals, who are professional accountants, as opposed to firms. The extant Code uses phrases such as: “members of audit teams, firms and network firms” (see 290.4 and 290.1) in relation to independence. The proposed international independence standards in the restructured Code refer to firms. In certain instances the actual act of compliance with a fundamental principle can only be achieved by individuals and thus the firm’s responsibilities extend to ensuring that the individuals professional accountants who comprise the firm’s partners and staff do comply, e.g., exercise due care etc. We suggest rather than drafting all requirements in terms of the firm, there needs to be more clarification of this or, in some cases, a distinction between the firm and its personnel may be necessary.

2.5 Increased clarity in drafting

We refer to our response to question 1 above in which we point to a few examples where changes to extant text result in less clarity compared to the wording of the extant Code.

Inconsistent Coverage in the Application Material

There is a lack of consistency in drafting the second sentence of the introductions dealing with specific matters. In some cases these paragraphs state the nature of the threat, but do not clarify which of the fundamental principles’ compliance might be threatened (e.g., 220.2, 270.2). In others, both the nature of the threat and the fundamental principle(s) the compliance with which might be threatened is(are) stated (e.g., 210.2, 230.2, 240.2). In others only the fundamental principle(s) the compliance with which might be threatened is(are) stated, but not the nature of the threat (e.g., 260.2).

Clarity and understanding might be improved if this were dealt with in a consistent manner. For example we question why 540.2 has been revised so as

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to delete the explanation that long association may impact objectivity and professional skepticism.

Reduction of the use of the word “generally”

We question whether the proposed replacement of “generally” with “usually” in 200.5A2 is helpful. It would be preferable for the Board to revisit this text, for example, if the IESBA believes that a professional accountant who - in promoting the position of the employing organization when furthering legitimate goals and objectives of the employing organization - does not make a statement that is false or misleading might create an advocacy threat, it would be helpful to give examples.

In any case, the impact on the requirement in R200.5 needs to be clear. We note that similar issues elsewhere have been dealt with differently on an awareness-only basis (e.g., R800.7, R800.8 R900.18).

Placement of Material

R200.8 and R200.9 together with accompanying application material deal with communication with those charged with governance. Such communication appears only relevant to the extent that it may constitute a safeguard measure in certain circumstances. This aspect is not clear from its placement, and so a brief explanation to this end would be helpful.

It is unclear to which requirement the application material in 200.7 A1 is intended to relate. Indeed, this material (unethical behavior by others) would appear more appropriately placed in or near to the Subsection dealing with NOCLAR, as the potential threat seems to be similar in nature. We accept that the issue of unethical behavior by others does not equate to NOCLAR, but suggest that any threat resulting from knowledge of unethical behavior by others would be a threat to the fundamental principles of integrity and professional behavior as explained in proposed 360.2.

New Text

IESBA proposes each Section contain one or more new paragraphs in its introduction. In regard to proposed 900.1, we question the need for examples. If examples are deemed helpful, we question whether more examples ought to be provided.

Unclear Wording and Related Translation Issues

The term “consider” is often subject to various interpretation in English, but also poses difficulties on translation. For this reason standard setters such as the IAASB have chosen to avoid using this term where possible. We note that there

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are many requirements for the professional accountant to consider certain courses of action (e.g., R220.9, R220.12, R260.9, R360.14, R360.17, R360.26 etc.). There are even more instances of its use in application material. Wherever possible an alternative term would be preferable, so that it is clear exactly what the requirement is intended to entail.

The IESBA's use of the word "may" is explained in no. 10 and 11 of the Section entitled "How to Use the Code". This notwithstanding to reduce the potential for mistranslation, it would be preferable to use a different term for situations denoting permission (e.g., "the professional accountant is permitted to ...", or "it is permissible for the professional accountant to ...").

360.28 A1 seems to be missing text. It should be clear that where the Code's NOCLAR provisions extend beyond matters identified in an audit according to ISAs additional documentation of such matters is required.

- 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.***

We refer to our letter of April 25th, 2017 concerning the "Proposed Revisions to Clarify the Applicability of Provisions in Part C of the Extant Code to Professional Accountants in Public Practice". We continue to take issue with proposed text:

R120.4 When facing an ethical issue, a professional accountant shall consider the context within which the issue has occurred. Where a professional accountant in public practice is performing professional activities pursuant to the accountant's employment or ownership relationship with the firm, there might be requirements and application material in Part 2 that are also applicable to those circumstances. If so, the professional accountant in public practice shall comply with the relevant provisions.

Reading proposed Section 2 in looking at the current project, it is clear that Section 200 is not designed for professional accountants in public practice as many of the examples are simply not relevant to their circumstances (e.g., 220.4.A1, as in this case independence requirements preclude an auditor from being involved in preparation and presentation of financial statements subject to audit). Thus, as we already commented in the afore-mentioned letter, the "applicability" to professional accountants in public practice should not be to the entire Part 2, but limited to the three areas (conflicts of interest; pressure; and

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inducements), as this otherwise introduces burdens to individual practitioners – burdens that are likely disproportionate to those professionals who need to be familiar with material that may, in practice, turn out to be of no or only sporadic relevance to their professional activities and circumstances.

Effective Date

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

The proposals in regard to divergent effective dates are highly complex. To the extent that such complexity may serve to confuse and could lead to the Code not being adopted or adhered to where it is adopted, we consider this undesirable.

Recent significant changes as well as the restructuring of the entire Code mean that many parties (e.g., professional accountants, regulators, educators etc.) will have to deal with issues such as, education, incorporation into firms' manuals and methodologies and – where applicable – translation, incorporation into national law or professional statutes etc. will have to be dealt with. The IESBA needs to be sensitive to this fact and should refrain from making changes in the near future so as to ensure a level playing field for the next several years.