

May 2018



Explanatory Memorandum: Exposure Draft 02/18 APES 110 Code of Ethics for Professional Accountants (including Independence Standards)

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Note: Definitions from the Exposure Draft 02/18 APES 110 Code of Ethics for Professional Accountants (including Independence Standards) are capitalised in the Explanatory Memorandum.

1. Background to the development of ED 02/18: APES 110 *Code of Ethics for Professional Accountants (Including Independence Standards)*

1.1 Introduction

This Explanatory Memorandum provides the background, development process and rationale for Accounting Professional & Ethical Standards Board Limited's (APESB) key decisions in respect of Exposure Draft 02/18 APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* (the Exposure Draft). It has been prepared by Technical Staff of APESB and approved by the Board of Directors of APESB.

The Explanatory Memorandum **does not** form part of the Exposure Draft and is not a substitute for reading it.

1.2 The Exposure Draft

APESB issues the Exposure Draft for public comment. This is the first of two Exposure Drafts that APESB expect to release in relation to the revision of the Code.

The proposed revisions in this first Exposure Draft are primarily intended to incorporate changes resulting from the restructured and renamed *International Code of Ethics for Professional Accountants (including International Independence Standards)* of the International Ethics Standards Board for Accountants (IESBA) which was issued in April 2018.

The IESBA is expected to release revised Inducements provisions in June/July 2018. APESB will issue another Exposure Draft based on these provisions in the second half of 2018.

The outcomes from both exposure drafts will be consolidated and APESB will then release the complete revised Code in late 2018 or early 2019.

1.3 Existing Standard APES 110 *Code of Ethics for Professional Accountants*

APESB issued the extant APES 110 in December 2010 and subsequently made amendments in respect of:

- the Public Interest Entity definition (December 2011);
- the Immediate Family definition and the referral of multiple audits (May 2013);
- revisions to the IESBA's Code primarily in respect of conflicts of interest and breaches (November 2013);
- revisions to the IESBA's Code in respect of Responding to Non-Compliance with Laws and Regulations (NOCLAR) and Non-Assurance Services provided to Audit and Assurance Clients (May 2017); and
- revisions to the provisions in respect of Long Association of Personnel with an Audit or Assurance Client (April 2018).

The Australian Code issued by APESB is based on the existing *Code of Ethics for Professional Accountants* issued by the IESBA.

1.4 Proposed revisions to the existing Code

The proposed revisions to the existing Code are as a result of the IESBA's revisions to its Code (as set out in Section 2) and APESB's amendments to the revised IESBA Code (refer to Section 3).

In developing this Exposure Draft APESB has considered feedback received from stakeholders at roundtables held in Melbourne and Sydney in 2016 and 2017. The roundtables were held by APESB to determine Australian views on the IESBA's exposure drafts proposing changes to the International version of the *Code of Ethics for Professional Accountants*.

1.5 Mapping Table

APESB Technical Staff have also prepared a Mapping Table to assist users of the restructured Code navigate to the corresponding provisions in the extant Code. The Mapping Table also provides a high-level summary of changes to the requirements and guidance in the Code. The Mapping Table is available on the APESB website www.apesb.org.au during the exposure period.

2. The IESBA's revisions to the Code

2.1 Background to the IESBA's revisions

The IESBA commenced revision of its Code in July 2014 and completed three significant projects and a short-term project to finalise its new Code. The projects undertaken by the IESBA, and the relevant section of this paper that sets out the high-level changes, are:

- Structure of the Code (Section 2.2);
- Safeguards and the applicability to Non-Assurance Services (Section 2.3);
- Review of Part C of the Code (including applicability) (Section 2.4); and
- Professional Scepticism (short-term project) (Section 2.5).

The IESBA also had to consider consequential amendments to its recently released pronouncements on NOCLAR and the Long Association of Senior Personnel with an Audit or Assurance Client (Long Association). A summary of these changes is included at Section 2.6.

Stakeholders should not rely on this summary of differences to determine what changes, if any, are required to their current practices, policies or methodologies. Stakeholders should refer to the full Basis for Conclusions released by the IESBA or read the entire Exposure Draft 02/18 to determine the significance of its proposals.

The IESBA are yet to finalise the provisions relating to Inducements for inclusion in the new International Code. The IESBA issued an exposure draft on the draft proposed Inducements provisions in September 2017 and are expected to issue the final provisions in mid-2018.

2.2 Structure of the Code

This project was undertaken by the IESBA to enhance the use, effectiveness and clarity of the international Code, and enable better implementation and enforcement of the Code's requirements.

The significant changes from this project were:

- Changing the name of the Code to *International Code of Ethics for Professional Accountants (including International Independence Standards)* to highlight the Independence Standards (extant Sections 290 and 291);
- Changing the Structure of the Code by:
 - swapping the order of the Parts relating to Members in Business and Members in Public Practice, i.e. extant *Part B - Members in Public Practice* is the new Part 3 and extant *Part C - Members in Business* is the new Part 2; and
 - creating a separate Part for the Independence Standards (extant Sections 290 and 291) and placing Part 4 after the new Part 3 to facilitate the linking of its application to Members in Public Practice;
- Increasing the prominence of the requirements to comply with the fundamental principles and apply the conceptual framework by including introductory paragraphs in each section to reiterate these obligations;
- Requirement paragraphs are now identified by the inclusion of an “R” in the numbering of the paragraph and the numbering being in **bold-type**;
- Application material paragraphs are now identified by the inclusion of an “A” in the numbering of the paragraph and will be located next to the relevant requirement paragraph, if applicable;
- Clearly specifying the responsibilities of individual Members, Firms and Network Firms, when applicable, to clarify when the Code applies to them;
- Definitions now presented as a Glossary, which also includes descriptions or explanations of terms used;
- Revising drafting conventions to implement the use of the active voice, the use of simpler and shorter sentences and to avoid legalistic and archaic terms; and
- Reducing the duplication of material which has led to the removal of:
 - extant Section 250 *Marketing Professional Services* now addressed in Subsection 115 *Professional Behaviour* of the new Code; and
 - extant Section 280 *Objectivity- All services* which is addressed in Subsection 112 *Objectivity* of the new Code.

In addition to the changes within the Code, the IESBA has also developed a *Guide to the Code* which provides high level guidance on the purpose of the Code, including its structure and how to use the Code.

2.3 Safeguards and the applicability to Non-Assurance Services

This project was undertaken by the IESBA with the aim of improving the clarity, appropriateness, and effectiveness of safeguards in the Code.

The significant changes from this project were:

- Addition of Section 120 *The Conceptual Framework* which sets out the details of the enhanced conceptual framework with more explicit requirements and application material to explain how to identify, evaluate and address threats to compliance with fundamental principles;
- An explicit requirement included for Members to address threats to compliance with the fundamental principles by eliminating the threats or reducing them to an Acceptable Level by:
 - eliminating the circumstances, including interests or relationships, that create the threats;
 - applying safeguards; or
 - declining or ending the relevant Professional Activity (paragraph R120.10);
- New requirement as part of the conceptual framework for Members to form an overall conclusion about whether the actions taken have addressed threats that were not at an acceptable level;
- New requirement as part of the conceptual framework for Members to re-evaluate and address threats to compliance with the fundamental principles if there is new information or changes in facts and circumstances that might impact the threat;
- Clarity provided around the term 'reasonable and informed third party' and how this concept can be used as a test of the appropriateness of actions undertaken;
- Revision of the description of 'safeguards';
- Clarification of the examples of safeguards where:
 - Certain extant safeguards are no longer considered safeguards because they do not meet the new definition. For example, 'conditions, policies and procedures established by the profession, legislation, regulation, the firm, or the employing organisation' are no longer considered to be safeguards. Several of these 'conditions, policies and procedures' are now considered as 'factors to consider' by Members in identifying and evaluating threats; or
 - Some extant 'safeguards' have been deemed ineffective or inappropriate in addressing threats to compliance with the fundamental principles, such as discussions or consultations with third parties;
- Explicit prohibition on assumption of management responsibilities for an Audit Client made more prominent (paragraphs R600.7 and R950.6);
- Explicit prohibition included on providing recruiting services (i.e. seeking candidates, reference checks) with respect to Director/Officer or senior management who have influence over accounting records/financial statements. This prohibition now applies to all Audit Clients, as opposed to just Audit Clients who were Public Interest Entities in the extant Code;
- Inclusion of guidance on materiality in relation to financial statements (paragraph 600.5 A3);
- Inclusion of guidance on considering the combined effect of threats when a Member or Firm provides multiple non-assurance services to an Audit Client (paragraph 600.5 A4);
- Inclusion of new factors to assist in identifying threats when providing Taxation Services, IT Services or Litigation Support Services for an Audit or Assurance Client; and

- Reducing the duplication of material which has led to the removal of details on the conceptual framework and statements on the need to evaluate and address threats to compliance from several Sections.

2.4 Review of Part C of the Code (including applicability)

This was undertaken by the IESBA to strengthen the Part C provisions to better promote ethical behaviour by Members in Business.

The significant changes from this project include:

- Addition of Section 270 *Pressure to Breach the Fundamental Principles* which sets out obligations and guidance for Members who may be under pressure to breach the fundamental principles;
- An explicit requirement for Members not to allow pressure on themselves, or not to exert pressure on others, to breach the fundamental principles (paragraph R270.3);
- Addition of an explicit requirement not to use discretion in professional judgements with the intent to mislead others or to influence an outcome inappropriately;
- Addition of an explicit requirement to use professional judgement and professional scepticism when the activities performed do not need to be in compliance with an applicable financial reporting framework;
- Addition of a requirement to use professional judgement when relying on the work of others; and
- Addition of paragraphs to clarify that the provisions in Part 2 (extant Part C) apply to Members in Public Practice when performing Professional Activities in accordance with their relationship with the Firm, whether as an employee, contractor or owner.

2.5 Professional Scepticism (short-term project)

This short-term project was undertaken by the IESBA to highlight how compliance with the fundamental principles embodied in the Code supports the exercise of professional scepticism and professional judgment in the context of audits, reviews, and other Assurance Engagements.

The significant change from this project is the inclusion of guidance material regarding professional scepticism in the conceptual framework. The guidance states that professional scepticism and the fundamental principles are inter-related principles. Therefore, compliance with the fundamental principles supports the exercise of professional scepticism in audit and assurance engagements.

The IESBA are also conducting a long-term project on professional scepticism which will consider how the concepts of professional scepticism and professional judgement apply to other services provided that are not audit and assurance services. This project has just commenced and there is no specified timeframe yet as to when these proposals will be released.

2.6 Consequential Amendments to NOCLAR and Long Association

As part of the revision of the International Code, the IESBA has made consequential amendments to the NOCLAR and Long Association provisions in the Code.

NOCLAR

The NOCLAR provisions have been relocated within the Code. Extant Section 225 *Responding to Non-Compliance with Laws and Regulation* which applies to Member in Public Practice is Section 360 in the new Code. Extant Section 360 *Responding to Non-Compliance with Laws and Regulation* which applies to Member in Business is Section 260 in the new Code.

The NOCLAR provisions have also been updated for the new drafting conventions but there were no substantive changes to the requirements and guidance provisions.

Long Association

The Long Association provisions have been relocated within the Code. The extant provisions in paragraphs 290.148 to 290.168 are now incorporated in Section 540 *Long Association of Personnel (including Partner Rotation) with an Audit Client*. The extant provisions in paragraphs 291.137 to 291.141 are now incorporated in Section 940 *Long Association of Personnel (including Partner Rotation) with an Assurance Client*.

The provisions have also been updated for the new drafting conventions but there were no substantive changes to the requirements and guidance provisions.

3. APESB's amendments to the revised IESBA Code

APESB commenced a project in 2017 to revise its Code to bring it into alignment with the revised IESBA Code issued in April 2018. In developing the Exposure Draft, APESB has used the IESBA Code as the base document and then included the following changes to tailor the IESBA Code for the Australian environment:

- Removal of the term 'International' from the title;
- The addition of a Scope and Application section;
- Requirement paragraphs are in **bold-type** font to achieve consistency with APESB's other pronouncements;
- APES 110 refers to Members whereas the IESBA Code refers to professional accountants;
- Defined terms are in title case;
- Designating any Australian specific paragraphs and definitions with an AUST prefix;
- The additional Australian definitions are AASB, Administration, AUASB, Auditing and Assurance Standards, Australian Accounting Standards, Member and Professional Bodies;
- APES 110 tailors the following IESBA defined terms to the Australian environment: Assurance Engagement, Audit Engagement, Director or Officer, Engagement Team, Financial Statements, Firm, Member in Public Practice, and Review Engagement;
- Definition of Engagement Team in APES 110 does not exclude individuals within the client's internal audit function who provide direct assistance on an Audit Engagement as the AUASB has prohibited the use of direct assistance in ASA 610 *Using the Work of Internal Auditors* (November 2013);
- APES 110 uses the term NOCLAR whereas the IESBA Code refers to 'non-compliance';
- APES 110 includes additional text in the section heading of Part 2 to indicate that the section includes employment relationships of Members in Public Practice;
- Enhancing the clarity of provisions in Sections 320 and 360 by replacing some of the references to the Proposed Accountant, Existing Accountant and Predecessor Accountant with the term Member in Public Practice;
- The addition of references to the requirements of applicable APESB pronouncements including requirement paragraph AUST R330.4.1 prohibiting the use of Contingent Fees in certain circumstances and a footnote to paragraph R350.3 about the requirements in APES 310 *Client Monies*;
- Paragraph AUST R400.8.1 in APES 110 mandates Firms to determine whether additional entities are Public Interest Entities;
- Revised the listing of entities in paragraph AUST 400.8.1 A1 that should be treated as Public Interest Entities to include private health insurers regulated by APRA under the *Private Health Insurance (Prudential Supervision) Act 2015*; and
- Amendments to refer to Australian legislation and applicable Accounting, and Auditing and Assurance Standards.

4. Effective Date

The Exposure Draft proposes an effective date for the new Code of 1 January 2020.