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Basis for Conclusions: APES 110 Code of Ethics for Professional Accountants (including Independence Standards)

Prepared by the Technical Staff of the Accounting Professional & Ethical Standards Board

BASIS FOR CONCLUSIONS:

APES 110 Code of Ethics for Professional Accountants (including Independence Standards)

This basis for conclusions has been prepared by Technical Staff of Accounting Professional & Ethical Standards Board Limited (“APESB”). It has been reviewed and approved by the Board of Directors of APESB and is provided for the benefit of stakeholders to gain an understanding of the background to the revision of APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* (the Code).

The basis for conclusions **does not** form part of APES 110 and is not a substitute for reading the Code.

Background

The IESBA issued a revised Code, *International Code of Ethics for Professional Accountants (including International Independence Standards)*, in 2018. The APESB commenced a process in 2017 to revise its Code to incorporate the changes to the IESBA’s Code.

Revisions to the existing Code

The revisions to the existing Code have primarily occurred from public consultations and the following inputs:

1. IESBA’s revisions to its Code;
2. APESB’s amendments to the IESBA’s Code for Australian context; and
3. APESB’s consideration of respondents’ comments to the exposure drafts released in relation to APES 110.

1. IESBA’s revisions to its Code

The IESBA commenced revision of its Code in July 2014 and completed three significant projects and two short-term projects to finalise its restructured Code. The restructured Code was issued in April 2018 with an amending standard for Inducements issued in July 2018.

The projects undertaken by the IESBA in revising its Code, and the relevant section of this paper that sets out the high-level changes, are:

- Structure of the Code (Section 1.1);
- Safeguards and the applicability to non-assurance services (Section 1.2);
- Review of Part C of the Code (including applicability) (Section 1.3);
- Professional Scepticism (short-term project) (Section 1.4); and
- Inducements (Section 1.5).

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The IESBA also had to consider consequential amendments to its recently released pronouncements on Non-Compliance with Laws and Regulations (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 1.6.

1.1 Structure of the Code

The Code structure 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;
- 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 (Part 4) for the Independence Standards (extant Sections 290 and 291) and placing it 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 the application of 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 restructured Code; and
 - extant Section 280 *Objectivity - All services* which is addressed in Subsection 112 *Objectivity* of the restructured Code.

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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.

1.2 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 (paragraph R120.11);
- 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 (paragraph 120.9);
- 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 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;
 - 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. These ‘safeguards’ have been removed from the restructured Code;
- Explicit prohibition on assumption of management responsibilities for Audit and Assurance Clients made more prominent (paragraphs R600.7 and R950.6);

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- 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 (paragraph R609.7);
- 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 Systems 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.

1.3 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 (paragraph R220.5);
- Addition of an explicit requirement to use professional judgement when the activities performed do not need to be in compliance with an applicable financial reporting framework (paragraph R220.6);
- Addition of a requirement to use professional judgement when relying on the work of others (paragraph R220.7); 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.

1.4 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 judgement 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.

1.5 Inducements

During the project to review Part C of the Code (refer to Section 1.3 above), it was identified that the Inducements provisions in the Code needed revision. The IESBA wanted to respond to continuing concerns about the prevalence of bribery, corruption and facilitation payments, and to ensure consistency between the provisions applicable to Members in Business and Members in Public Practice.

The significant change to the Inducements provisions is the establishment of a comprehensive framework that clearly delineates the boundaries of acceptable Inducements. A key component of this framework is a new intent test that prohibits the offering or accepting of Inducements where there is actual or perceived intent to improperly influence the behaviour of the recipient or of another individual. The framework also:

- Clarifies the meaning of an Inducement;
- Establishes a requirement to understand and comply with laws and regulations that prohibit the offering or accepting of Inducements in certain circumstances, such as in relation to bribery and corruption;
- Guides Members in applying the enhanced conceptual framework in the Code where there is no improper intent; and
- Provides enhanced guidance on the offering and accepting of Inducements by Members' immediate or close family members.

1.6 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 Members in Public Practice is Section 360 in the restructured Code. Extant Section 360 *Responding to Non-Compliance with Laws and Regulation* which applies to Members in Business is Section 260 in the restructured Code.

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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 Section 290 are now incorporated in Section 540 *Long Association of Personnel (including Partner Rotation) with an Audit Client*. The extant provisions in Section 291 are now incorporated in Section 940 *Long Association of Personnel 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.

1.7 The IESBA's Basis for Conclusions

In conjunction with the release of the IESBA's revised Code and amending standard on Inducements, the IESBA have released a Basis for Conclusions Document for each of the key projects set out in Sections 1.1 to 1.5 above.

Refer to the [release of the revised Code](#) on the IESBA website for the following Basis for Conclusions:

- Structure of the Code;
- Safeguards and the applicability to Non-Assurance Services;
- Review of Part C of the Code (including applicability); and
- Professional Scepticism.

Refer to the [release of the Inducements Standard](#) on the IESBA website for the Basis for Conclusions on Inducements.

2. APESB's amendments to the revised IESBA Code

In developing the revised APES 110, 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:

- The title of APES 110 does not include the term 'International';
- 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;

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- The additional Australian definitions are AASB, Administration, AUASB, Auditing and Assurance Standards, Australian Accounting Standards, Member, Professional Bodies and Professional Standards;
- 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, Public Interest Entity, 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);
- The addition of paragraphs prefixed as AUST are to deal with applicable Australian laws and regulations, Australian Accounting Standards, Auditing and Assurance Standards, Accounting Professional & Ethical Standards or to address specific matters in the Australian environment;
- 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 in APES 110;
- 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 350.2 to refer to 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.

3. APESB's consideration of respondents' comments to the exposure drafts in relation to APES 110

APESB received seven submissions from the professional accounting bodies, Firms and a public sector organisation.

There were no substantive changes made to APES 110 as a result of the exposure draft process. However, there were two key matters raised by stakeholders, which are summarised below, including how APESB have addressed them.

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(a) Reporting of breaches under s307C of the Corporations Act 2001.

An issue was raised regarding the *Corporations Act 2001* (the Act) requirement to report breaches of the requirements in APES 110, in particular breaches of the auditor Independence requirements.

Section 307C of the Act requires the auditor to provide a declaration to their audit client that they have complied with the auditor independence provisions of the Act and relevant codes of professional conduct (e.g. APES 110). However, there is an exemption from the need to disclose some breaches if the auditor had in place a quality control system that provided reasonable assurance that the auditor and his or her employees complied with the auditor independence sections of the Act.

The exemption only applies to breaches of the Act's auditor independence requirements. It does not apply to breaches of the professional Code of Conduct (i.e., APES 110) provisions which are not included in the auditor independence provisions of the Act.

Paragraph R510.4 (extant paragraph 290.108) of APES 110 requires other partners in the same office as the Engagement Partner to not hold a Direct Financial Interest or material Indirect Financial Interest in Audit Clients of the Engagement Partner. This requirement is not replicated in the Act.

If paragraph R510.4 was breached, even inadvertently, the auditor would either need to:

- issue a qualified declaration of independence, or
- apply to ASIC for an exemption order under s340 of the Act to avoid having to issue a qualified declaration of Independence.

APESB Technical Staff have raised this issue with the Australian Securities and Investments Commission (ASIC) senior management, who have indicated their willingness to develop a legislative instrument to address the issue. Therefore, no amendments to APES 110 are considered necessary in relation to this issue.

(b) Rationale for Australian specific Independence provisions

A stakeholder commented that it is not easy to determine the rationale for the inclusion of some Australian paragraphs in the Code. In particular the stakeholder noted paragraphs AUST R400.12.1, AUST R410.3.1, AUST 410.3.1 A1 and AUST R900.15.1.

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Identification of multiple threats

Paragraphs AUST R400.12.1 and AUST R900.15.1 have been included in the Code at the request of a regulator to address issues in practice where Members in Public Practice were not considering the effect of accumulated threats to Independence but were considering them as separate or discrete events. This paragraph requires Members to consider the aggregate effect of multiple threats to Independence.

Referral of multiple audit clients

Paragraphs AUST R410.3.1 and AUST 410.3.1 A1 have been included in the Code to address circumstances where auditors may be receiving multiple referrals from a single source. APESB has identified that this is a common risk in the Self-Managed Superannuation Fund (SMSF) sector which is also likely to be relevant in other circumstances.