INTERNATIONAL FEDERATION
OF ACCOUNTANTS
545 Fifth Avenue, 14th Floor
New York, New York 10017
Internet: http://www.ifac.org
Tel: +1 (212) 286-9344
Fax: +1 (212) 856-9420

Agenda Item
2

Board International Ethics Standards Board for Accountants

Meeting Location: Brussels, Belgium

Meeting Date: June 24-25, 2008

Drafting Conventions

Objectives of Agenda Item

1. To approve for exposure proposed changes to improve the clarity of the Code.

Background

At its April 2008 meeting, the IESBA discussed a draft exposure draft presented by the Task Force[1] charged with recommending new drafting conventions for the Code that would improve its clarity, including considering the implications of the IAASB's Clarity project on the Code and other matters related to the clarity of the Code. The Task Force met immediately after the meeting to consider the direction of the IESBA.

The IESBA held a conference call on May 16th to consider a revised draft. The Task Force met on May 26th and held a conference call on May 30th to revise the exposure draft.

Issues

Implications of IAASB Clarity Project

As agreed by the IESBA, the Code has been reviewed to identify provisions that are intended to convey requirements and many of those requirements, which are often conveyed by use of the word "should" in the existing Code, have been re-written using the word "shall." The intention was not to create any new requirements but, rather, to clarify the original intent.

The Task Force developed a description of the meaning of the word "shall." The IESBA discussed the following description on the May conference call:

---

[1] Ken Dakdduk (Chair), David Devlin, Jean-Luc Doyle, Kariem Hoosain, Peter Hughes, Barbara Majoor, Michael Niehues and Tim Volkmann

> "In the context of this Code, "shall" specifies a requirement with which a professional accountant or firm has to comply unless compliance is prohibited by law or regulation or an exception is permitted by this Code."

In addition to some editorial suggestions to this description, a question was raised as to whether the Code should provide that in exceptional circumstances it might be appropriate to depart from a requirement in the Code. The Task Force agreed that it would consider this matter.

The preface to the ISAs (Revised preface ¶16 and 17) discuss the requirements in the ISAs and a departure from a requirement as follows:

> "The requirements of each ISA are contained in a separate section and expressed using the word "shall." The auditor applies the requirements in the context of the other material included in the ISA.
>
> The auditor complies with the requirements of an ISA in all cases where they are relevant in the circumstances of the audit. In exceptional circumstances, however, the auditor may judge it necessary to depart from a relevant requirement by performing alternative audit procedures to achieve the aim of that requirement. The need for an auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective."

In addition, ISA 230 Audit Documentation (redrafted) contains the following requirement in the case of a departure:

> "If, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement in an ISA, the auditor shall document how the alternative audit procedures performed achieve the aim of that requirement, and the reasons for the departure."

In considering this matter, the Task Force recognized that the type of departure it has been asked to consider is not one that results from an inadvertent violation. The Code already contains provisions regarding inadvertent violations. ¶100.10 states that an inadvertent violation, depending on the nature and significance of the matter, may not be deemed to compromise compliance with the fundamental principles provided, once the violation is discovered, the violation is corrected promptly and any necessary safeguards are applied. ¶290.33 states that if an inadvertent violation occurs, it generally will not be deemed to compromise independence provided the firm has appropriate quality control policies and procedures in place to maintain independence and, once discovered, the violation is corrected promptly and any necessary safeguards are applied to eliminate any threat or reduce it to an acceptable level. The paragraph also states that the firm shall determine whether to communicate the matter to those charged with governance.

In determining whether the Code should provide that in exceptional circumstances it might be appropriate to depart from a requirement in the Code, the Task Force considered the following advantages and disadvantages:

Advantages

- It is not possible to foresee every circumstance and the change from “should” to an absolute “shall” might have unintended consequences;
- An absolute “shall” does not fit comfortably within a Code that seeks to provide a framework for dealing with matters of judgment and ethics;
- If changing "should" to "shall" changes the meaning of a provision, a provision dealing with departures is necessary so that the project does not result in a substantive change to the Code;
- The ISAs provide for a departure from a requirement in specific circumstances; and
- If it is agreed that in exceptional circumstances a departure may better serve the public interest, then the Code should explicitly address this matter and provide guidance on when such a departure could occur.

Disadvantages

- The IESBA's discussions to date on this project indicate that provisions denoted by a "should" in the current Code are intended to convey a requirement that the professional accountant is required to follow. An ability to depart from such a requirement, even if limited to exceptional circumstances, would weaken the current Code;
- Including guidance in the Code on when a departure could occur carries with it the risk that it could be interpreted in a way that encourages non-compliance; it could prove exceedingly difficult to write the guidance in a way that eliminates that risk;
- In some jurisdictions the term “should” has already been translated into “shall” and seems to be working; therefore, including departure guidance in the Code could weaken an existing position; and
- A departure provision is not necessary because, when judging the severity of a departure, regulators and member bodies will take the specific facts and circumstances into account.

A majority of the Task Force are of the view that, weighing the advantages and disadvantages, it is appropriate for the Code to provide that in exceptional circumstances a departure from a requirement in the Code may better serve the public interest. Some Task Force members are not supportive of this approach and believe that the Code should not contain such a provision, or that such a provision is unnecessary, largely for the reasons cited above under "Disadvantages."

In developing the provision, the Task Force considered what conditions would need to be met before a departure from a requirement can occur. In considering this matter, the Task Force developed a few illustrative fact patterns. The following two patterns are presented for the IESBA’s consideration in determining, if it is appropriate to have such a provision, the conditions that need to be met before a departure can occur.

Scenario 1

A planned rotation of the engagement partner on a public interest entity audit client did not occur because of the unexpected death of the planned successor. The firm, under ¶290.152, determines that the engagement partner should remain on the client for an additional year while the firm takes the necessary steps to identify another successor and make the necessary arrangements to, for example, obtain a visa for the individual to enter the jurisdiction and in question and work, and a license to practice in that jurisdiction. However, before the new successor partner assumed the position of engagement partner, the individual left the firm. It is not possible for the firm to put a third individual in place before the end of the additional year. In such circumstances, in the absence of a strict requirement, the only alternative would seem to be for the firm to resign from the audit. Such a resignation could result in significant difficulties for the client and might lead to its failure to meet regulatory reporting requirements.

Scenario 2
¶290.139 provides that if subsequent to the partner ceasing to be a key audit partner, the partner joins the audit client as a director or officer, no safeguards could reduce the threat to an acceptable level unless the client has issued audited financial statements covering a period of not less than twelve months and the partner was not a member of the audit team with respect to that audit.

A former lead audit partner for an audit client that is a public interest entity leaves the firm to join a non-client. One week before the public interest entity audit client issues its audited financial statements covering the subsequent twelve months for which the partner was not a member of the audit team, the partner joins the client as a director. Again, in the absence of a strict requirement, the only alternative would seem to be for the firm to resign from the audit.

The Task Force considered these two scenarios as it revised ¶100.4 - which now reads:

> “The use of the word "shall" in this Code imposes a requirement on the professional accountant or firm to comply with the specific provision in which “shall” has been used. Compliance is required unless prohibited by law or regulation or an exception is permitted by this Code. In exceptional circumstances, a departure from a requirement in the Code may better serve the public interest. Before such a departure can occur, the professional accountant shall:
>
> - Determine that the departure is expected to be non-recurring;
> - Determine that the departure will not compromise the professional accountant’s compliance with the fundamental principles;
> - Discuss the matter, including any safeguards that will be applied, with those charged with governance, or with the relevant regulatory authority; and
> - Document how, in the accountant’s professional judgment, the public interest is better served by a departure from a requirement in the Code, any safeguards that will be applied, the nature of the discussions with those charged with governance or the relevant regulatory authority and the

rationale for concluding that the accountant's compliance with the fundamental principles is not compromised.

In all cases where a departure will occur and compliance with the requirement can subsequently be achieved, the professional accountant shall comply with the requirement as soon as possible."

The Task Force considered whether additional factors should be present before a departure could occur. For example:

- Whether the exceptional circumstance that triggers the departure should be outside the accountant's control.

  The Task Force noted that this is a requirement in ¶290.152 for a partner to remain on the audit team for an additional year ("in rare cases due to unforeseen circumstances outside the firm's control"). The examples cited above are demonstrative of circumstances that are outside of the accountant's control. On balance, several Task Force members believe that including this as an overall requirement for departure throughout the Code could be too limiting because it is not possible to know today all circumstances where a departure might better serve the public interest and whether those circumstances will always be outside of the accountant's control;

- Requiring the approval of those charged with governance or the relevant regulatory authority.

  The Task Force noted that this would be inconsistent with the remainder of the Code, which calls for a discussion with those charged with governance but does not require their approval, nor the approval of a regulator. As a practical matter, the Task Force believes that after discussing the matter, the accountant would take into account the views of those charged with governance or the relevant regulatory authority. In addition, under the proposal the accountant would be required to document the nature of the discussions. The Task Force, therefore, concluded that it was not necessary to require approval.

- Requiring that the matter be discussed with the relevant regulatory authority.

  The Task Force considered whether, if a relevant regulator authority was prepared to discuss such a matter, this should be a requirement. The Task Force was of the view that in many circumstances discussion with those charged with governance would be sufficient. However, this would need to be judged based on the facts and circumstances of each situation and the accountant should be permitted to determine whether a discussion with those charged with governance would be sufficient. The Task Force therefore concluded that the matter should be discussed with either those charged with governance or a relevant regulatory authority.

Action requested

IESBA members are asked to consider whether the Code should provide that in exceptional circumstances a departure from a requirement in the Code can occur. If IESBA members believe that such a provision is appropriate, they are asked to consider the conditions that should be met before such a departure can occur.

Other Changes

Section 210 – Changes in Professional Appointment

The section provides guidance for the incumbent accountant and the successor accountant. The paragraphs have been restructured to provide a more logical flow.

¶290.25 – This change has been made to make it clear that the additional provisions in the Code were established by the IESBA taking into account the degree of public interest in certain entities. The change is intended to reduce the potential for 290.25 to be read as sending a message for firms or member bodies to take any action; that message is sent only by 290.26.

Definition of acceptable level

This has been modified to state that the specific facts and circumstances are those that were available to the professional accountant at that time. This has been added to make it clear that the determination is made based on what was available at the time. It, therefore, excludes hindsight.

Effective Date

The IESBA included a proposed effective date in its December 2006 exposure draft. The IESBA discussed this matter at its January 2008 meeting. It concluded that an effective date of approximately 18 months after approval with no transition provisions would likely strike the right balance between requiring timely adoption and providing sufficient time for member body adoption. The IESBA also agreed that, as proposed in the exposure draft, an "at a point in time" effective date would be appropriate – that is the old requirements would be effective up to a specified date, after which the new requirements would be effective. This contrasts with the existing effective date for Section 290 which applies to assurance engagements when the assurance report is dated on or after June 20, 2006.

The document is currently scheduled for approval, pending PIOB clearance, by the IESBA at its meeting in April 2009 and will be issued after the PIOB has confirmed that due process has been followed. Assuming that this takes place in June 2009, a period of approximately 18 months later would be December 15, 2010.

Initially, the IESBA considered an effective date of one year after approval, but concluded that a longer period was necessary to allow member bodies sufficient time to follow their own due process in adopting the changes. If a member body does need, for example, 18 months to adopt the changes, this would mean that if the effective date was 18 months after it is issued by IFAC, the changes in that particular jurisdiction would be effective almost immediately after the member body had adopted it. In such circumstances, the professional accountants in that jurisdiction would have very little time to implement the changes. For example, if the revisions were issued in June 2009 with an effective date of December 15, 2010 and a member body issued its revised Code on November 15, 2010, accountants in that jurisdiction would have one month to comply with all of the new requirements (curtail prohibited services, adopt the more stringent partner rotation requirements etc). Accordingly, the IESBA is asked to consider whether transition provisions for certain provisions are necessary in light of the new timeline described above.

The IESBA has previously considered some transition provisions, which were included in the December 2006 exposure draft. The provisions below are taken from the December exposure draft and have been adjusted for the new revised release date of June 2009 and an effective date of December 15, 2010 which is approximately 18 months later:

- *Partner Rotation* – The proposals extend the existing partner rotation requirements to all key audit partners and to all firms, except those that meet the regulatory exception in ¶290.155. Where the proposals would require additional individuals to rotate (i.e., those not required to rotate under the existing provisions) the IESBA proposed in the December 2006 ED that it was appropriate to provide an additional year before this requirement is effective Therefore, such rotation would be effective two and a half years after the approval of the final standard. For example, key audit partners who are neither the engagement partner nor the individual responsible for the engagement quality control review would be subject to the rotation requirements after December 15th 2011. Similarly the rotation requirements would start on December 15th 2011 for firms that do not currently rotate partners but rather, under the existing Code, apply alternative safeguards to address the threat. However, it is impractical to require partner rotation in the middle or close to the end of a year and, therefore, the IESBA is asked to consider providing a transition provision under which rotation would be required for the first fiscal year beginning after December 15, 2011.

  Assuming a December 31 year-end, the effect of this transition provision is illustrated as follows:

  Scenario 1

  Assume a firm has only a few people with the necessary knowledge and experience to serve as a key audit partner and there is no regulatory exception in that jurisdiction. Under the current Code, the firm has been applying alternative safeguards whereas under the revised Code, rotation would be required. At December 15, 2010 (the effective date), the 2010 audit is the lead engagement partner's eighth year in that position and is the fourth year for the individual responsible for the engagement quality control review. Under the proposed transition provision, the engagement partner may stay on the team for the 2011 audit but, may not participate in the 2012 audit, provide quality control for the 2012 audit, consult with the engagement team or the client regarding technical or industry-specific, issues, transactions or events or otherwise influence the outcome of the 2012 audit. The engagement quality control reviewer may remain on the team until the completion of the 2013 audit.

Scenario 2

Assume the audit engagement is subject to the existing rotation requirements. There are five key audit partners on the engagement. The following chart indicates the period that will have been served by each key audit partner as of December 15, 2010 and when they would be required to rotate, including the three new partners who will be subject to rotation for the first time under the new requirements of the Code and applying the proposed transition provision:

	2010 is xth year in position	Fiscal year after which rotation is required
Engagement Partner	7th	2010
Engagement Quality Control Reviewer	4th	2013
Other Key audit partner 1	6th	2011
Other key audit partner 2	8th	2011
Other Key audit partner 3	2nd	2015

- *Public Interest Entities* – The proposals extend the independence requirements that apply with respect to audits of listed entities to all other public interest entities. The IESBA was of the view that it is appropriate to provide an additional year before these requirements are effective. Therefore, these requirements would be effective December 15, 2011.
- *Provision of Non-Assurance Services* – The proposals expand some of the restrictions related to the provision of certain non-assurance services. The firm should not contract for such services after the effective date of the final standard and will have six months after the effective date to complete any ongoing services that were contracted for before the effective date. For example, a firm should not contract for such services after December 15^{th} 2010 and would have until June 15^{th} 2011 to complete any ongoing services that were contracted for before December 15^{th} 2010.

Action requested
IESBA members are asked to consider whether the 18 month effective date remains appropriate and, if so, whether any transitional provisions should be provided.

Material Presented

Agenda Paper 2	This Agenda Paper
Agenda Paper 2-A	Mark-up of changes since the May conference call
Agenda Paper 2-B	Complete Mark-up of Code
Agenda Paper 2-C	Clean Copy of Code
Agenda Paper 2-D	Explanatory Memo

Please note that Agenda Paper 2-A will be used in the meeting. The complete mark-up (2-B) and the clean copy (2-C) are provided for the reference of the Board.

Action Requested

1. IESBA members are asked to approve the exposure draft. The affirmative vote of 12 members of the Board is necessary for approval.
2. The draft Explanatory Memo is provided for the information of IESBA members. This document is not approved by the IESBA but IESBA members are encouraged to review it and provide any comments they might have directly to staff.