

**Minutes of the Meeting of the  
Ethics Committee of the International Federation of Accountants  
Held on September 8-9, 2003  
At the ICAEW, London, United Kingdom**

	<b>Members</b>	<b>Technical Advisors</b>
<i>Present</i>	Marilyn Pendergast (US, Chair)	Lisa Snyder
	Christine Catasta (Austria)	
	Francisco Papellás Filho (Brazil)	
	Donald G Wray (Canada)	John Babiak
	Pekka Luoma (Finland)	
	Thierry Karcher (France)	Jean-Luc Doyle
	Herbert Graf Von Treuberg (Germany)	Tim Volkmann
	Richard George (Ireland)	Heather Briers
	Akira Hattori (Japan)	
	Wim P Moleveld (Netherlands)	
	Michael Foulds (UK)	Tony Bromell
		David York
<i>Absent:</i>	Ahmed Belaifa (Tunsia)	Stephen Spector (Canada)
		Jouko Ilola (Finland)
		Dr. Reiner J. Veidt (Germany)
	<b>Observers</b>	
<i>Present:</i>	David Devlin (TAC Observer)	
	Andrew Pinkney (Observer)	
	David Winetroub (TAC Observer)	
	<b>IFAC Technical Staff</b>	
<i>Present:</i>	Jim Sylph (Technical Director)	
	Jan Munro	

## 1. Introduction and Administrative Matters

The chair opened the meeting and welcomed all those attending. The Committee approved the minutes of the May 2003 meeting.

## 2. Discussion of Section 8

Ms Pendergast introduced the review of Section 8 of the Code. It was noted that while it was timely to review Section 8 in light of recent international developments and the implementation experience of member bodies, it was important to also consider that the implementation date for the Section is still in the future and consequently some member bodies are still in the process of implementing the new requirements.

### DEFINITION OF AUDIT CLIENT

It was noted that the interaction of the definitions of audit client and related entity could be confusing. The definition of audit client states, "...when the audit client is a listed entity, audit client will include its related entities" and the definition of a related entity comprises five parts including:

- an entity that has control over the client (provided the client is material to the entity),
- an entity that has significant influence over the client (provided the interest in the client is material to the entity),
- an entity over which the client has control, an entity over which the client has significant influence; and
- an entity under common control with the client.

The following implications of these two definitions were noted:

- Under Section 8 a firm would be prohibited from holding a 20% interest in a subsidiary of a listed audit client but there is no corresponding prohibition with respect to an unlisted audit client (although this would be subject to the overall threats and safeguards approach);
- A literal reading of the definitions would mean that as an example, a firm could not have any direct financial interest in an entity that was under common control with an audit client that is a listed entity.

It was agreed that the Committee would consider a paper dealing with this issue. Don Wray and David Devlin agreed to assist staff in the preparation of this paper.

### PUBLIC INTEREST ENTITIES

The Committee discussed how Section 8 deals with public interest entities and considered whether any additional or more specific guidance in this area was needed. It was agreed that because Section 8 is to be applied in many different jurisdictions the guidance given was appropriate. It was recognized that individual member bodies may find it appropriate to provide more specific guidance that would be applicable to their particular jurisdiction.

#### AUDIT COMMITTEES

The Committee discussed whether Section 8 should provide more explicit guidance regarding the auditor's communication with the audit committee regarding matters that might be thought to bear on independence. In particular the Committee considered the need for audit committee prior approval of professional services rendered by the auditor.

It was noted that the IFAC report *Rebuilding Public Confidence in Financial Reporting* had commented in this area believing that the auditor's primary relationship with the company should be with the board, through its audit committee or similar governance body and had stated that there be "greater control over the auditor provision of non-audit services through, for example, the audit committee approving non-audit services provided by the auditor." It was also noted that FEE considers this to be an area of corporate governance and will be issuing a paper in this area.

The Committee expressed support for the IFAC efforts in the area of corporate governance and concluded that the current guidance contained in Section 8 was appropriate from an ethical viewpoint.

#### EMPLOYMENT WITH AN ASSURANCE CLIENT

It was noted that both the new SEC rules and the EU provisions provide a mandatory "cooling off" period before a person who is on the engagement team (SEC) or a key audit partner (EU) could join an audit client in certain key positions. The Committee concluded that because Section 8 is to be applied in varying jurisdictions it was appropriate for a threats and safeguards approach to be taken.

#### PARTNER ROTATION

Paragraph 8.151 of the Code states that, for listed entities, the lead engagement partner should be rotated after a pre-defined period, normally no more than seven years and should not resume the lead engagement partner role until a further period of time, normally two years, has elapsed. It was noted that a strict reading of these words would mean that an individual who has served as the lead engagement partner on the audit of a listed entity could assume the role of, for example, second partner on the client. It was noted that at the time Section 8 was drafted International Auditing Standards did not require a second partner on listed entities. The Committee agreed that the intention of the partner rotation requirements was a person who has served as lead engagement partner for a defined period, normally for seven years would not be permitted to serve on the engagement team until a further period of time, normally two years, has passed. It was agreed that that Section 8, as drafted, did not reflect this intention.

It was agreed that an amendment to paragraph 8.151 should be prepared for the approval of the IFAC Board at its next meeting.

#### PROVISION OF NON-AUDIT SERVICES

The Committee reviewed the sections of the Code that deal with the provision of non-audit services (8.155 to 8.201) in light of recent international developments and feedback

from member bodies who had implemented, or were in the process of implementing, the Code. The Committee concluded that no change was required to Section 8 in this area.

#### OTHER

The Committee reviewed other minor areas where Section 8 was different from either the new SEC rule or the EU provisions and concluded that no changes were required to Section 8 at this time.

#### CONTINUED MONITORING

The Committee concluded that, with the exception of the issues associated with (a) the application of related entities in the definition of audit client and (b) partner rotation, no further changes were necessary to Section 8 at this time. The Committee further concluded that it would be appropriate to continue to monitor member bodies' implementation of the Code.

#### CLARITY OF SECTION 8

It was noted that some member bodies, in responding to the implementation questionnaire that had been sent, expressed concern that their members felt Section 8 was overly complex. It has been noted that the Section contains differing requirements for assurance engagements and audit engagements, for listed entities and for private entities, for firms and for network firm.

The Committee discussed various methods of making Section 8 more accessible including:

- An executive summary;
- A short members guide;
- A topical index; and
- A list of the prohibitions that are contained in the Section.

It was agreed that at the next meeting the Committee would review a paper that outlines the prohibitions that are contained in Section 8. It was further agreed that it was important that this paper carefully explain that under all circumstances a practitioner was required to apply the threats and safeguards framework.

### **3. Review of Exposure Drafts**

#### STATEMENTS OF MEMBERSHIP OBLIGATION

The Committee reviewed the exposure draft dealing with six Statements of Membership Obligations.

#### *SMO1 – Quality Assurance*

The Committee discussed the SMO requirement that the quality assurance review team be independent. It was noted that the report issued by the quality assurance review team might or might not be an assurance report. The Ethics Code only requires independence when the practitioner is issuing an assurance report. It was agreed that, because of the nature of the assignment, it was essential that the individuals on the team be independent. It was agreed that, in its response to the IFAC Board on the Exposure Draft, the Committee would recommend that the SMO explicitly state that even though any report

issued will not necessarily be an assurance report the quality assurance review team members should be independent from the firm they were reviewing.

It was further agreed that the response will contain a recommendation that the SMO should only refer to the Code of Ethics rather than paraphrase parts of it. In particular SMO 1 paragraph 39 is not necessary and the reference in SMO 1 paragraph 41 confidentiality “rules” would be better characterized as confidentiality “requirements”.

#### *SMO4 – IFAC Code of Ethics for Professional Accountants*

The Committee agreed that the response to the ED would recommend that the language in SMO 4 paragraph 1 be revised to be consistent with the proposal in the Code ED that “No member body ... is allowed to apply less stringent standards than those stated in the IFAC Code.” The following proposed change would be communicated in the response “Member bodies should ~~use their best endeavors to work towards~~ implementation, when and to the extent possible under local circumstances, of the IFAC Code and other pronouncements developed by the Ethics Committee.”

The Committee also agreed that the response should recommend that SMO 4:

- paragraph 3 should contain the wording currently contained in the footnote but should also say that the Code is a standard;
- paragraph 10, last bullet, should refer to “results of interpretation/counseling/advice questions that are of broad interest are subject to...”; and
- appendix paragraphs 2 and 4 should be aligned to reflect the obligation that member bodies implement the Code; and
- appendix paragraph 5 should be aligned more closely with 8.10 of the Code.

#### *SMO6 – Investigation and Discipline*

The Committee agreed that the response should state that the meaning of the second sentence of paragraph 7 is not clear. The sentence states “A range of penalties should be available to those who judge such issue.”

#### *IAASB QUALITY CONTROL EXPOSURE DRAFT*

The Committee discussed the contents of the IAASB Quality Control Exposure Draft. Committee members were very concerned that because the ED paraphrases the Code and in places seems to go further than the Code. The Committee noted that this paraphrasing had resulted in differences between the ED and the Code. These differences create confusion and could lead to significant enforcement difficulties. It was agreed that this point should be communicated in a response to the ED. The following points would be noted as illustrative examples of the problems caused:

- ISQC 1.18 refers to matters that *may* create threats to independence whereas the Code refers to threats to independence;
- The Code requires network firms to be independent from audit client and for other assurance clients consideration should be given to any threats that the firm has reason to believe may be created by network firm interests and relationships. The ISQC in the ED states that the policies and procedures address the independence

- requirements of the Code including the identification of relationships that exist between the firm and network firm that may “reasonably be thought to bear on the firm’s independence and the objectivity of the engagement teams.”
- ISQC 1.25 requires the firm to set out criteria against which all audits of non-listed entities, assurance and related service engagements should be evaluated for the purpose of determining whether the engagement partner should be rotated after a specific period. The Code states that using the same personnel on an engagement over a long period may cause a familiarity threat – but it does not require rotation.
  - The definitions of “engagement partner” and “lead engagement partner” are not consistent. Under Section 8 any partner responsible for signing the audit report on a subsidiary of a listed entity (for example for statutory purposes) would be subject to the rotation requirements. This is not the case with the QC ED.
  - The definition of “engagement team” in the QC ED is not consistent with the definition of “assurance team” in the Code. To bring the two definitions into line it will be recommended that the QC definition is consistent with part (a) of the definition in the Code – that is “all professionals participating on the assurance engagement”. When Section 8 of the Code is next revised this part of the definition would be referred to as the “engagement team”.
  - ISQC 69 requires that the quality control reviewer did not participate in the performance of the audit, assurance or related service involving the same client and the same subject matter for the preceding period or, in the case of an audit client that is a listed entity, for a period of 24 months before the start of the period covered by the current engagement. This requirement is not part of the Code and establishes an independence requirement that goes beyond the Code.
  - ED ISA 220.8 requires the engagement partner obtain an understanding of whether there are *potential* threats to compliance with relevant ethical requirements. The Code refers to threats rather than potential threats.

The Committee also agreed that the response would state that it would be useful if the final standard included a definition of an engagement quality control reviewer.

#### **4. IFAC Update**

The Committee received an update on IFAC Reform Proposals that had been discussed by the IFAC Board.

#### **5. Future Role of the Committee**

At its November meeting the IFAC Board will discuss the resources and activities of the Ethics Committee. In particular it will consider the request for additional resources (full time rather than part time staff) and the ability of the Committee to issue standards and guidance in its own right.

The Committee discussed the additional activities that it could undertake assuming that the IFAC Board agrees to the request.

It was noted that close cooperation with the IFAC Education Committee (“EDCOM”) was very important. The Committee discussed the EDCOM draft Terms of Reference dealing with approaches to the development and maintenance of professional values and ethics in accounting education programs. The Committee agreed that the topic was very important and that it was critical that there be very active and close cooperation on this subject. The Chair asked that members who were interested in working on this project communicate their interest to her after the meeting.

Possible future oversight of the Committee was discussed and it was agreed that at the next meeting of the Committee draft Terms of Reference should be discussed.

## **6. Clarity of the Code**

The Committee discussed whether the clarity of the code could be improved. In particular the Committee discussed whether adopting the concept of black-lettering would be helpful in this regard. The Committee concluded that because the Code is based on a framework of principles black-lettering might confuse rather than clarify its application. It was agreed that the summary of the “prohibitions” (see item 2 above) would be reviewed to determine whether this is something would be useful for other parts of the code.

## **7. Independence Guidance for Members in Government**

The Committee discussed whether additional guidance should be provided for independence requirements for members in government. It was agreed that a paper should be prepared for the next Committee meeting.

## **8. Closing**

The chair thanked the ICAEW for hosting the meeting and members, technical advisors and staff for their input and closed the meeting.

## **9. Future meeting dates**

February 2-3, 2004 (New York) – confirmed  
May 6-7, 2004 (Vienna) – to be confirmed