



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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Agenda Item

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Committee: Ethics
Meeting Location: New York
Meeting Date: February 2-3, 2004

Review of Exposure Draft Comments

Objectives of Agenda Item

To review the significant issues raised by respondents to the July 2003 ED *Proposed Revised Code of Ethics for Professional Accountants*. To agree on the approach to be taken to address these issues.

Approach

This agenda paper summarizes the significant issues for discussion at this meeting. Agenda paper 3-A presents all of the comments received, analyzed by issue and paragraph number. After the February meeting it is proposed that the ED will be redrafted to take into account the positions reached on the significant issues, and other issues raised. The redrafted document will be presented for approval at the May 2004 meeting. In addition to the redrafted document, Committee members will receive an updated version of Agenda Paper 3-A showing how each of the comments received have been addressed.

Background

As of January 10, 2004, 38 comment letters had been received. A list of the responses received is contained in Appendix A to this Agenda Paper. The responses can be categorized as follows:

Member bodies	28
Firms	4
Others	6
Total	38

Overview

The comment letters were generally very supportive of the approach taken in the ED. In particular, many respondents commented favorably on the move towards a principles-based approach and elevating the Code from a model code to a standard which must be complied with by IFAC member bodies and firms, unless prohibited by law or regulation. The following comments are illustrative:

- Since many ethical dilemmas arise from new and changing situations, we consider a principles-based approach appropriate – IDW
- The establishment of a conceptual framework for applying fundamental principles for professional ethics is in the best interest of the public – Grant Thornton
- A principles based approach...enable[s] accountants...to analyze ethic issues in a consistent and logical manner – AICPA
- The Committee is pleased to note that the exposure draft may contribute to the restoration of public confidence in the auditing profession – Basel Committee
- As a standard the Code will be much more influential around the world – ACCA

Structure

The ED asked respondents to comment on whether they found the structure of the ED to be understandable and useable. Of the 26 respondents that explicitly addressed this question, 10 supported the proposed structure and 16 questioned whether the proposed structure was understandable and useable. The following concerns were noted:

- Having the fundamental principles set out in all three parts makes the Code repetitive. Many respondents felt that this repetition detracts from the usability of the Code and does not encourage the reader to continue reading;
- The structure increases the risk that Parts B and C will be used as stand-alone documents;
- The structure is artificial and fails to recognize that accountants in practice are also accountants in business and they face issues that are not directly-client related. Consequently, many of the circumstances discussed in Part C apply equally to accountants in practice; and
- The repetition increases the length of the document and obscures the key principles.

Several suggestions were made to change the structure to make it more understandable and useable. Two respondents referred to other Codes that, they believe, have a clearer structure. These Codes, CIPFA and ICANZ, are included as Agenda Papers 3-B and 3-C. They are presented as reference material for Committee members – who should scan the documents and consider whether there are any lessons that can be learned from the alternative approaches taken.

The following alternative approaches were suggested by respondents:

1. High level Code

A respondent (LSCA) felt that the structure should set out the key principles more clearly. This respondent felt that the examples should be removed from the main part of the document and published separately, if at all. In the respondent's view, the examples tend to have a North American/European slant to them and tend to be more applicable to large organizations. Therefore, the respondent believes that a high-level Code should be published and leave it to others to interpret and apply the code.

2. Two stand-alone sections

A respondent (CNCC) felt that clarity would be improved if the Code has only two sections – one section would be applicable to professional accountants in public practice and the other section applicable to professional accountants in business. Each section would be complete and stand-alone.

3. Principles, rules and application of rules

One respondent (ICANZ) felt that the structure should be divided between principles, rules and application of the rules. Under this structure, there would be three sections to the Code:

- Fundamental principles – these form the basis of the behavior expected from all members – the respondent notes that these could likely be summarized on one page;
- Rules – each fundamental principle is supported by a number of specific Rules that prescribe aspects of professional and ethical behavior expected of members; and
- Application of Rules – this section would establish appropriate ethical behavior in a number of typical situations that may be faced by members.

The ICANZ Code, Agenda Paper 3-C, adopts this structure.

4. Principles and framework, specific circumstances

Several respondents (including ACCA, FEE, IDW, MIA, AAB) felt that the three parts of the Code should be re-structured as follows:

- Part A – establishes the high level principles and explains the conceptual framework of the threats and safeguards approach;
- Part B – explains how the principles contained in Part A apply to specific circumstances faced by professional accountant in public practice; and
- Part C – explains how the principles contained in Part A apply to specific circumstances faced by professional accountant in business.

Part A would make it clear that the purpose of Parts B and C is to assist accountant in practice and business respectively, apply the principles contained in Part A. It was also felt that this approach would avoid the perception that Part A is too public practice oriented.

Committee members are asked to consider the concerns expressed and the various proposed approaches, and the examples provided in Agenda Papers 3-B and 3-C and determine whether any of these approaches would make the Code more useable and understandable.

Framework approach

The ED asked respondents to comment on whether the explanation of the framework approach was sufficiently clear. Responses to this question were split. A slim majority felt that the framework approach was sufficiently clear, but several respondents had concerns in this area. The following points were made:

- While there is a limited explanation of the framework approach much of the explanation contained in Section 8 should be incorporated into Part A of the Code. Part A should explain in greater detail how the principles are to be applied and what questions should be asked.
- The framework does not contain enough detail and is not as clear as Section 8.
- Parts B & C do not clarify sufficiently the application of the conceptual approach because the text refers mainly to the threats to compliance with the fundamental principles rather than

discussing the nature of the threats and the possible safeguards. Section 8 is clearer in this respect.

- The commentary on the fundamental principles, the discussion of the threats and safeguards, the more detailed discussions in the latter part of Parts B & C and the material in the front of Section 8, does, in totality explain the approach. However the pieces are disbursed throughout the Code.

Committee members are asked to consider the concerns expressed and consider whether changes should be made to the way the framework approach is described in paragraphs 1.9–1.13, for example by incorporating some of the thoughts contained in Section 8.

Principles

The ED asked respondents whether they thought the fundamental principles were sufficiently articulated. Respondents commented on the following aspects of the principles:

Clarity

Several respondents noted that the fundamental principles were not sufficiently clear and some comments that the standard would be strengthened by “black lettering” the fundamental principles.

Objectivity

The principle of objectivity “imposes an obligation on all professional accountants that their professional or business judgment should not be compromised by prejudice or bias, conflict of interest or the undue influence of others.” (ED 3.1)

Several respondents noted that accountants in business cannot always be unbiased:

- Business members and members employed in practice firms, have a duty to their employers and will inevitably be biased;
- Members in business have a duty of loyalty to their employer and an obligation to advance the employer’s legitimate business interests.

One respondent suggested that either the word bias be removed or the principle be reworded to describe objectivity as a state of mind which has regard to all considerations relevant to the task but no other.

Committee members are asked to consider whether black-lettering the principles would a useful change. Members are also asked to consider the comments received on the use of the term “bias” in the principle of objectivity.

Guidance on specific circumstances

The ED asked respondents whether they thought the guidance on specific circumstances contained in Parts B and C cover the appropriate activities and relationships in sufficient depth.

Many respondents felt that the coverage was appropriate noting that the Code cannot cover all circumstance accountants are likely to face in many different jurisdictions. There were, however, some suggestions for additional guidance on:

- Ethical conflict resolution – possibly using case study examples of how to apply the fundamental principles in the specific circumstances;
- Confidentiality – particularly relationships of professional accountants i.e. relationships between partners and employees within a practice;
- Members in the not-for-profit sector;
- Conflict of interests;
- Advertising and solicitation;
- Operation of professional practice offices;
- Client's in dispute;
- Timeliness;
- Receipt of commissions from third parties;
- Termination of engagements; and
- Professional Fees.

In addition, several respondents stated that the Part C appears to suggest resignation as a safeguard rather too willingly and does not explore other courses of mitigating action. It was noted that the Section should recognize that resignation from employment is a far more serious consequence than resigning from one of several clients, and that other possibilities would be explored first.

Committee members are asked to consider whether additional guidance should be provided on the above topics and whether some additional language should be added to Part C as suggested.

Prohibitions

The ED asked respondents whether the prohibitions (“ultimate safeguard”) contained in the ED were appropriate.

Several respondents stated that the prohibitions as stated were appropriate. However, many respondents commented on the wording of the prohibitions noting:

- The prohibitions are not clearly stated;
- In some cases the prohibitions are expressed in soft term for example:
 - If, after exhausting all relevant possibilities, the matter remains unresolved, professional accountants should, *where possible*, refuse to remain associated with the matter. A1.22
 - Where it is not possible to reduce the threats to an acceptable level, professional accountants should *ordinarily* decline to enter into a client relationship; B2.7

- Where the threats cannot be eliminated...professional accountants in public practice should...*consider* whether to decline the engagement; B 4.8
- If the company or entity seeking the opinion will not permit communication with the existing accountant, professional accountants *should consider* whether, taking all circumstances into account, it is appropriate to provide the opinion sought; B5.2
- Where it is not possible to reduce the threat to an acceptable level, professional accountants *may* conclude that it is appropriate to *consider* resigning from the employing organization; C2.4

Committee members are asked to consider whether the instances of perceived permissive language cited above are appropriate and whether the Code should be reviewed to identify additional instances of such perceived permissive language.

Effective Date

The ED asked respondents whether the proposed effective date of January 1, 2006 was appropriate.

No respondent stated that a longer lead-time was necessary. The majority of respondents felt that early application should be encouraged and a few respondents felt that the Code should be effective immediately or January 1, 2005.

Committee members are asked to consider whether early application of the Code should be encouraged.

Definitions

Several respondents underlined the need for consistent use of definitions in all documents issued by IFAC. In particular, the following definitions were cited as problematic in this regard:

- Assurance team
- Assurance engagement
- Firm
- Network firm
- Listed entity

Consistency of these definitions will be discussed under Agenda Item 4 (Conforming amendments as a result of the new Assurance Standard) and Agenda Item 6 (Quality Control ED).

Professional Accountant in Business

Several respondents commented on this definition stating:

- It would be clearer if the definition was stated in the negative – i.e. professional accountants that are not in public practice;
- The definition refers to accountants that are *employed* – it should be clarified that this includes accountants engaged in an executive and non-executive capacity;

- It is not clear whether this would include, for example, accountants that are teachers in a college on contract.

Committee members are asked to consider whether the definition of Professional Accountants in Business should be clarified.

Public Interest

Several respondents commented on the guidance on the Public Interest. Paragraphs 1.6-1.8 of Part A state that:

“A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Therefore, a professional accountant’s responsibility is not exclusively to satisfy the needs of the individual client or employer. 1.6

The public interest is considered to be the collective well-being of the community of people and institutions the professional accountant serves, including clients, lenders, governments, employers, employees, investor, the business and financial community and others who rely on the work of professional accountants. 1.7

The Code sets out the professional accountant’s ethical responsibilities to act in the public interest. 1.8”

Several respondents felt that this was too broad and could, inappropriately expand liability. Various suggestions were noted:

- Delete paragraph 1.7 in its entirety;
- Redraft paragraph 1.6 to state that the distinguishing mark is *not to act against the public interest*;
- Limit paragraph 1.7 by referring to *others who the professional accountant reasonably expects will rely on the work*;
- Limit paragraph 1.7 by referring to *others who rely on the work of the professional accountants to the extent permitted by local laws or regulations*; and
- Limit paragraph 1.7 by referring to *others, insofar as within the competence of the professional accountant to influence and in so far as they are entitled to rely on the work of the professional accountant*.

Committee members are asked to consider whether they feel paragraphs 1.6-1.8 are worded too broadly and, if so, whether any of the proposed changes are appropriate.

Use of Experts

Some respondents commented on the guidance on Use of Experts in Part B. The respondents felt that the Code should make it clear that the professional accountant should ensure that the total knowledge available, including that of the expert, is sufficient to comply with the fundamental principles. These respondents questioned whether using an expert is an appropriate safeguard – if the professional accountant does not have appropriate competence there is a limit to which he/she can use the work of an expert because the professional accountant needs to be able to assess the work of the expert and periodically check the expert's competence.

Committee members are asked to consider whether the guidance contained in Part B 2.13-2.14 is sufficiently clear.

Association with False and Misleading Information

Some respondents commented on the statement in Part A 2.22 that a professional accountant should not be associated with “reports, returns, communications or other information where they believe that the information contains a materially false or misleading statement.”

Respondents noted:

- The Code should envisage the situation where a professional accountant in practice is associated with, for example financial statements that are false and misleading, and issues a reservation of opinion;
- A professional accountant should not be associated with any false or misleading statements – materiality should not be a factor;
- The Code appears to permit a professional accountant to make disparaging statements about another professional accountant so long as those statements could be substantiated – this behavior should be discouraged.

Committee members are asked to consider the comments received on association with false and misleading information and determine whether any changes to the Code are appropriate.

Material Presented

Agenda Paper 3-A	Analysis of Comment Letters Received
Agenda Paper 3-B	Standard of Professional Practice on Ethics - CIPFA
Agenda Paper 3-C	ICANZ Code of Ethics
Agenda Paper 3-D	FEE – A Conceptual Approach to Safeguarding Integrity, Objectivity and Independence Throughout the Financial Reporting Chain
Comment letter	These are posted on the public part of the IFAC web-site

Action Requested

Ethics Committee members are asked to:

1. Review the significant points raised in this agenda paper and consider the appropriate response for addressing the comments; and
2. Read the analysis of the comment letters received and consider whether any of the items are significant such that they should be discussed at this meeting.

Appendix 1**Exposure Draft “Proposed Revised Code of Ethics for Professional Accountants”****Respondent Summary****Member bodies**

1	Association of Chartered Certified Accountants	ACCA
2	American Institute of Certified Public Accountants	AICPA
3	Australian Accounting Bodies	AAB
4	Basel Committee	Basel Com
5	Certified Public Accountants of Kenya	CPAK
6	Canadian General Accountants	CGA
7	Canadian Institute of Chartered Accountants	CICA
8	The Chartered Institute of Management Accountants	CIMA
9	Chartered Institute of Public Finance and Accountancy	CIPFA
10	Compagnie Nationale des Commissaires aux Comptes and the Conseil Supérieur de l'Ordre des Experts-Comptables (CNCC)	CNCC
11	Controller and Auditor General of New Zealand.	CAGNZ
12	CPA Australia - Malaysia Division	CPA Malaysia
13	Education Committee of the International Federation of Accountants IFAC	EDCOM
14	Fédération des Experts Comptables Européens – European Federation of Accountants (FEE)	FEE
15	Foreningen af Statsautoriserede Revisorer	FSR
16	Institut Der Wirtschaftsprüfer	IDW
17	Institute of CA of New Zealand	ICANZ
18	Institute of Chartered Accountants in England and Wales	ICAEW
19	Institute of Chartered Accountants in Ireland	ICAI
20	Institute of Cost and Management Accountants of Pakistan	ICMAP
21	Instituto Nacional de Contadores Públicos	INCP
22	The Japanese Institute of Certified Public Accountants	JICPA
23	London Society of Chartered Accountants	LSCA
24	Malaysian Institute of Chartered Accountants	MIA
25	National Association of State Boards of Accountancy	NASBA
26	Norwegian Institute of Public Accountants	NIPA
27	Nederlands Instituut van RegisterAccountants	NIVRA
28	Portuguese Institute of Statutory Auditors	OROC
29	South African Institute of Chartered Accountants	SAICA
30	Institute of Certified Public Accountants of Singapore	ICPAS

Firms

31	Deloitte Touche Tohmatsu	D&T
32	Ernst & Young	E&Y
33	Grant Thornton	GT
34	PricewaterhouseCoopers	PwC

Others

35	Group of accountants from Netherlands	Group NL
36	Jean Bechard	Jean Bechard

