

**Minutes of the Meeting of the
Ethics Committee of the International Federation of Accountants
Held on February 14-15, 2005
New York, New York USA**

	Members	Technical Advisors
<i>Present</i>	Richard George (chair)	Heather Briers
	Frank Attwood	
	Christian Aubin (Day 1 only)	
	Jean-Francois Cats (deputy-chair)	
	Ken Dakkduk	Lisa Snyder
	David Devlin	Andrew Pinkney
	Mark Fong	
	Akira Hattori	
	Geoffrey Hopper	Sylvie Soulier
	Thierry Karcher (Day 2 only)	Jean-Luc Doyle
		Tony Bromell
	Wim P Moleveld	Barbara Majoer
	Russell Philp	Tiina-Liisa Sexton
	Jean Rothbarth	
	Volker Rohricht	Tim Volkmann
	David Winetroub	Peter Hughes
	Donald Wray	John Babiak
	IFAC Technical Staff	
<i>Present:</i>	Jim Sylph (Technical Director)	
	Jan Munro	
<i>Regrets</i>	Neil Lerner	Sandrine Van Bellinghen
	Pekka Luoma	Stephen Chan
		Jouko Ilola

1. Introduction and Administrative Matters

Mr. George opened the meeting and welcomed all those attending and especially the new members and technical advisors. The chair noted that Mr. Lerner and Mr. Luoma had sent their apologies and had given their proxies to Mr. Hughes and Ms. Munro respectively. The chair further noted that Mr. Karcher had sent his apologies for day 1 and had given his proxy for that day to Mr. Doyle and Mr. Aubin would be unable to attend day 2 and had given his proxy for that day to Dr. Rohricht.

Minutes of the Previous Meeting

The minutes of the public session of the previous Ethics Committee meeting were approved as presented.

Ethics Committee Consultative Advisory Committee

Mr. George reported that the first meeting of the Ethics Committee Consultative Advisory Group (Ethics CAG) had been held on December 1, 2004. The membership of the Ethics CAG was still being finalized to ensure the appropriate representation. Accordingly, as an interim step Mr. George had chaired the first meeting.

Mr. George, and other members of the Ethics Committee, provided the CAG with an overview of the activities of the Committee including the projects in progress and those approved but not yet started.

One question raised by a CAG member related to the Ethics Committee's strategy with respect to international convergence. Mr. George noted that this would be discussed as part of Agenda Item 6.

PIOB

Mr. George reported that he, and the two chairs of the other Public Interest Activity Committees, had met with the chair of the Public Interest Oversight Board, Stavros Thomadakis.

Liaison with Other IFAC Committees

Mr. George reported that he and Ms. Munro had met with Mr. Connell, chair of the IFAC Public Accountants in Business Committee (PAIB), to discuss an ongoing PAIB project dealing with corporate codes of conduct. Mr. George reported that Mr. Connell was pleased with the interest of the Ethics Committee and that, as the project progressed, it would be determined how the two committees should work together.

2. Discussion of Exposure Draft Responses

Mr. George provided some background to the exposure draft, issued in October 2004, noting that at the previous meeting the Committee had approved for exposure revisions to the Code of Ethics. These revisions related to changes to the independence requirements to align the section with the Assurance Framework issued by the IAASB and to provide that the individual responsible for the engagement quality control review of a listed entity be subject to the same rotation requirements as the engagement partner.

Alignment with the Assurance Framework

Mr. Pinkney presented the proposal of the working group to address the comments received related to the changes to align the independence section to the Assurance Framework (“the Framework”). He noted that many ED respondents had commented that:

- the terms “subject matter” and “subject matter information” were difficult to understand and were not clearly explained in the Code; and
- the ED could be read as precluding practitioners from performing direct reporting engagements.

To respond to these comments the working group proposed that:

- Section 290 contain a short discussion of the key terms provided in the Framework with a statement that for a full understanding of the elements and objectives of an assurance engagement it is necessary to refer to the Framework;
- Section 290 address assertion-based and direct reporting engagements and for direct reporting engagements recognize the difference between those direct reporting engagements where the practitioner obtains an representation from the responsible party that evaluates or measures the subject matter and those direct reporting engagements where the practitioner directly evaluates or measures the subject matter because there is no such written representation;
- For assurance engagements where there are multiple responsible parties, when determining the parties from which independence is required consideration may be given to the materiality of the subject matter (or subject matter information) for which a particular party is responsible; and
- The Committee should issue explanatory material that explains the rationale of the positions taken and provides examples of the application.

Ms. Munro led the Committee through an example developed by the working group to illustrate the implications of the proposals on various types of assurance engagements.

Committee members, recognizing the complexity of the Framework, expressed continuing concern with the complexity of the proposals. It was noted that the Framework was complex because it was developed to provide a generic framework that applied to a wide variety of assurance engagements. It was further noted that, irrespective of the complexity in the Code, it was important to develop independence standards that were robust and capable of consistent application.

It was agreed that part of the complexity related to the flow of the document and it was agreed that the explanation of an assurance engagement, description of subject matter/subject matter information and the types of assurance engagements (contained in paragraph 290.7a-c) was appropriately included in the section but should follow the paragraph that introduces an assurance engagement (paragraph 290.1a). It was further agreed that the description of an assertion-based engagement and a direct reporting engagement (paragraphs 290.7d and e respectively) was appropriately contained in the document but the working group should consider whether the paragraphs should precede

the description of the application of the section to these types of engagements (paragraph 290.9a and 290.10a).

With respect to assurance engagements where there are multiple responsible parties, the Committee agreed that consideration should be given to whether it is necessary to apply the provisions in the section to each responsible party but questioned whether this consideration would be based on materiality.. The working group had proposed that the materiality of the subject matter, for which a particular party was responsible, could be taken into consideration when determining whether it is necessary to apply the provisions in the section to each responsible party. The Committee noted that:

- qualitative as well as quantitative aspects should be considered; and
- the independence considerations would depend on whether the practitioner was providing a conclusion on each individual subject matter or the subject matter taken as a whole.

It was further noted that it was important to take into account the effect of an omission or error on the users of the assurance report. The Committee also questioned whether a determination based on materiality was the appropriate test and in accordance with the conceptual framework or whether the consideration should be whether an interest or relationship with the responsible party could give rise to a threat to independence that was other than clearly insignificant. The working group agreed to consider these points.

In considering the proposals with respect to direct reporting engagements where there is no written representation from the responsible party that has evaluated or measured the subject matter, the Committee questioned whether the issue was whether there would be an unacceptable self-review threat. The Committee noted that in some such circumstances, it might be that the practitioner in effect puts himself or herself in the role of management. In considering the application of the proposal to an engagement to report on the effectiveness of internal control, the Committee noted that even if there is no written representation from management, provided management has designed the controls and has documented the controls, such engagements do not pose an unacceptable threat to independence. If, however, the practitioner had designed and documented the controls, it would not be appropriate to express an opinion on the effectiveness of the controls.

The Committee noted that it continued to struggle with the boundaries of an assurance engagement and to develop realistic examples of assurance engagements, and in particular to distinguish between assertion-based and direct reporting engagements. The Committee recommended that the working group meet with representatives of the IAASB to discuss the matter.

The Committee agreed that it would be useful to issue some form of explanatory material at the same time as changes to the Code were issued. The Committee recommended that, because such material would contain examples of assurance engagements, it was important that the IAASB be comfortable with and provide input to the explanatory material.

Rotation of Engagement Quality Control Reviewer

The Committee agreed with the proposal that the individual responsible for the engagement quality control review of a listed entity be subject to the same rotation requirements as the lead engagement partner.

Other

The Committee agreed with the proposed changes to the paragraphs dealing with gifts and hospitality, to ensure that sections 260 and 350 are not seen as more stringent than section 290.

The Committee discussed a question that had been raised on the transitional rule in IT 2003-02. The interpretation provides that a partner may serve in that role for an additional two years from the date of implementation before rotating off the engagement. The Committee agreed that an engagement partner who had served in that capacity for seven or more years as of December 31, 2003 on the audit of a December 31 year-end company, the two additional years would be 2004 and 2005. This would permit the engagement partner to issue the opinion on the 2004 and 2005 financial statements.

The Committee agreed that the issue of an effective date and the transitional period for rotation of the individual responsible for the engagement quality control review should be determined when the Code is approved.

The working group agreed to revise the paragraphs aligning the Code to the Framework and to develop explanatory material for approval at the next Committee meeting in June.

3. Independence

Mr. Cats presented the views of the Independence Task Force. The independence provisions of the Code were issued in November 2001. Since issuance, several jurisdictions have taken steps to restore the loss in confidence in financial reporting created by corporate failures. Some of these steps have related to auditor independence requirements. In addition, IOSCO has commented that the independence requirements contained in the Code do not reflect current expectations for auditor independence. The Task Force has performed a detailed review of the independence requirements contained in the Code and has compared them to requirements of other jurisdictions.

Structure of section

The Task Force considered whether the section should be restructured to separate the requirements/guidance for financial statement audit engagements from the other assurance engagements. The Committee agreed with the Task Force recommendation not to separate the section noting that doing so would lead to a large amount of repetition. The Committee noted, however, that consideration should be given to making the requirements for audits of listed entities clearer.

Clarity of prohibitions

Mr. Cats noted that Section 290 contains prohibitions that are written in many different ways. He also noted that now that the conceptual framework is more established, the style of expressing prohibitions could become more direct. The Committee agreed with the Task Force recommendation that Section 290 should be reviewed to determine which prohibitions could be expressed more directly but cautioned that the prohibitions should be categorized within the context of the framework and not become a list of rules.

The Committee reviewed two examples of “user friendly” guides to independence that had been prepared by two member bodies. The Committee concluded that such guides were useful and agreed that a Guide should be prepared when the changes to the independence requirements are approved.

Mr. George noted that the IAASB has a project dealing with clarity of standards. It was agreed that the Committee should consider changes as a result of this project to determine whether any of the changes would be relevant to the Code.

Safeguards

The Task Force had considered the use of safeguards in Section 290. The Task Force was of the view that certain safeguards, while not specifically addressing a threat to independence did help with compliance with the fundamental principles. Mr. Cats also noted that some respondents to the implementation survey had expressed the view that some of the examples in Section 290 contained safeguards that, absent other safeguards, would generally not be strong enough to appropriately reduce any significant threat to independence. The Committee agreed that, while it was important to recognize there are a wide variety of safeguards, the specific examples should be reviewed to ensure that the safeguards noted are sufficiently robust. The Committee also agreed that it would be useful to explain that certain safeguards assist in compliance with the fundamental principles.

The Committee discussed the safeguard of communicating with the audit committee and noted that some had indicated that this was not a safeguard that could reduce a threat to independence. The Committee noted that, for example, with the provision of non-audit services, communication with an independent audit committee could be a very effective safeguard. The Committee agreed that the Code should clearly explain why such communication is an effective safeguard.

The Committee agreed with the Task Force recommendation that Section 290 should be reviewed with the view to emphasizing that if safeguards are not available to reduce a threat the engagement should be declined. The Committee did, however, caution the Task Force not to incorporate unnecessary repetition.

Application to Public Interest Entities

Mr. Cats noted that some respondents to the survey had provided a definition of a “public interest entity” when adopting the independence requirements. The Committee agreed with the Task Force recommendation that it would not be possible to develop a global

definition of such entities because of the wide variety of such entities. The Committee also agreed that it would not be appropriate to add to the examples contained in the Code because there was a danger of creating a long list of examples that would detract from the substance of the issue.

Management threat

The Committee considered the APB definition of a management threat and agreed with the Task Force recommendation that it would not be appropriate to create a fifth category of threat. The Committee noted that, depending on the circumstances; a “management threat” could otherwise be characterized as one of the four threats already contained in the Code – for example a self-review threat or an advocacy threat.

Detailed review of Section 290

Ms. Munro led the Committee through a detailed review of the Section 290 providing the Task Force’s recommendations with respect to which parts of Section 290 need to be revisited.

The Committee provided the following guidance to the Task Force:

- It would be useful to clarify the interpretation of the engagement team as it relates to specialists. The IAASB has commenced a project to revise ISA 620 *Using the Work of an Expert* and it would be appropriate to co-ordinate with the IAASB.
- The definition of a listed entity should not be expanded to include publicly available collective investment vehicles. Such vehicles vary from jurisdiction to jurisdiction and it would not be possible to find a definition that was appropriate for all legal environments. Therefore, if there is a need to specifically address such vehicles, it should be done by each jurisdiction.
- Consideration should be given to extending the restrictions on holding financial interests in an audit client that is not a listed entity to certain related entities of that audit client. The Committee agreed that it was appropriate not to extend the restrictions related to the provision of non-audit services but asked the Task Force to consider whether the restrictions on employment relationships should also be extended.
- The existing documentation requirement should be given more prominence.
- The restrictions on employment with an audit client should require a cooling off period that would normally be no less than one year. There should be an exemption to this cooling off period for individuals who, subsequent to accepting employment with an entity, find themselves in a restricted position solely because of a business combination or other similar transaction.
- If it is known that a person is to join an audit client, it should be mandatory to perform a review of the significant judgments made by that individual. The significance of the judgments would be considered in the context of the whole audit. Thus, judgments made by a lower level staff person might not warrant review whereas judgments made by a senior manager likely would.
- Paragraph 290.152 recognizes that long association of senior personnel may create a familiarity threat. The task force should consider whether the section should be strengthened to indicate that in some engagements it might be necessary

- to extend the rotation provisions to partners other than the engagement partner and the individual responsible for the engagement quality control review.
- Paragraph 290.158 states that certain activities would generally create too significant a threat to independence. In all circumstances it would be inappropriate to determine which recommendations of the firm should be implemented or to report in a management role to those charged with governance. Also greater guidance should be provided as to what is meant by authorizing or consummating a transaction.
 - Greater guidance should be given in the area of taxation services which encompass a broad range of services and while they generally do not create unacceptable threats to independence consideration should be given to certain tax services to determine whether they create a threat to independence.
 - The guidance on recruiting senior management should be clarified to explain that a practitioner cannot act as a negotiator (i.e., one who can commit the client to the terms of a transaction) for an assurance client because this would create an unacceptable advocacy threat.
 - The restrictions on corporate finance services should apply only to audit clients rather than all assurance clients.
 - The Code should recognize that a threat to independence in appearance may be created if a partner is compensated for procuring non-audit services from a listed entity audit client.

The Committee also asked the Task Force to revisit the guidance in paragraph 290.25 and the phrase “exert direct and significant influence over”.

The views of the Committee on the areas of independence that need to be revisited will be considered at the Forum to be held in October. Accordingly, the Task Force will prepare revised wording and a consultation document for the consideration of the Committee at its June 2005 meeting.

4. Due Process

Mr. George presented proposed due process and working procedures. He noted that the IFAC Board had agreed in principle that the three Public Interest Activity Committees (IAASB, Ethics and the Education Committee) should follow the same single due process. Accordingly, staff had developed proposed due process procedures.

The Committee noted that a 90-day comment period was appropriate for the Ethics Committee. It would be problematic if this were to be extended to 120 days because, with only three meetings per year, this could significantly extend the length of time to develop and approve revisions to the Code.

5. Results of Self-review

Mr. George presented the report on the results of the self-review process that was completed in 2004 and tabled with the IFAC Board at its November 2004 meeting.

6. Convergence

Mr. George led the Committee in a discussion of the Ethics Committee's strategy on international convergence noting that the IAASB had an explicit strategy on convergence and the issue had been raised at the Ethics CAG.

It was noted that the members of the Forum of Firms were committed to following the Code, which ensured a significant amount of global compliance. It was further noted that the objective would not necessarily be complete harmonization. The EU recognized this in proposed 8th directive by stating that a member state may choose to impose additional requirements on auditors in that country, but such additional requirements could not be imposed on the auditors of foreign subsidiaries.

It was noted that the Code applies to all professional accountants who are members of IFAC member bodies. As such it was important that the Code, which is behavioral, is sensitive to cultural differences.

It was further noted that the Code should not merely be a minimum Code; rather it should reflect best practice. Best practice evolves and it is important that the Code adapts as best practice changes.

It was further noted that because of jurisdictional differences it would not be possible or appropriate to eliminate all instances of "Code plus". For example, in a particular jurisdiction, professional accountants in public practice might perform a significant number of insolvency engagements, which would necessitate ethical guidance for such engagements.

Ms. Munro led the Committee through a consideration of the implications of the paper "Implementation of International Accounting and Auditing Standards" Lessons Learned from the World Bank's Accounting and Auditing ROSC Program" prepared by Peter Wong. Ms. Munro indicated that the IFAC Board has determined that it was necessary to develop a common understanding of how international convergence will be assessed. This common understanding is important because it will ultimately form the basis for assessment of compliance.

The Committee agreed that it was appropriate to define:

- Convergence as a process towards the adoption (and implementation) of equivalent standards; and
- Equivalent standards as national standards that may differ in detail from the IFAC standards but their application would yield the equivalent or a similar result as the IFAC standards.

In discussing which parts of the Code a member body would have to incorporate to conclude the standards were equivalent, the Committee concluded that such standards should contain:

- The conceptual framework which requires a professional accountant to identify threats to compliance with the fundamental principles and apply safeguards to reduce a threat that is other than clearly insignificant to an acceptable level;
- The five fundamental principles and five categories of threats (or equivalents); and
- All of the examples contained in the Code (assuming that professional accountants belonging to the member body perform the relevant service).

The Committee noted that the “prohibitions” contained in Section 290 are written in different ways. For example, in some cases a paragraph states that a professional accountant can only perform a certain activity if certain specified safeguards are applied, in other cases a paragraph states that an activity cannot be performed. The Committee agreed that both types of prohibitions would need to be incorporated into a member body’s Code for the standard to be considered to be equivalent.

The Committee agreed that for standards to be equivalent they should have the same authority as the Code – for example, it would not be appropriate for a member body to adopt the conceptual framework as a standard and adopt the example as a lesser authority.

The Committee re-iterated that a member body should be free to add to the Code, for example, by providing additional examples of the application of the framework. The Committee also concluded that for standards to be considered equivalent it would not be necessary for the member body to clearly differentiate the modification.

The Committee discussed whether equivalent education standards were a prerequisite of equivalent ethical standards. It was noted that education standards were relevant with respect to attaining professional competence. It was further noted that this principle could be attained through other means. Therefore, the Committee concluded that equivalent education standards were not a prerequisite.

The Committee agreed that ethical standards would only be considered equivalent if they kept up to date with changes to the Code. The Committee noted that, when setting the effective date of a particular change to the Code consideration was given to the length of time that was needed to adopt the Code.

The Committee agreed that the planning committee should consider the Ethics Committee’s views and:

- Draft a convergence strategy for the consideration of the Committee; and
- Develop a proposal for approval that describes what parts of the Code would need to be incorporated into the standards in a national jurisdiction for that jurisdiction to state that it has equivalent standards.

Both documents would be presented at the June 2005 meeting.

7. Network firms

Mr. Attwood presented a proposed revised definition of network firm and background information that had been developed by a joint Task Force of the Ethics Committee and the IAASB. He noted the proposal had been discussed at the annual meeting of the forum of firms and the firms had generally indicated they were comfortable with the approach.

The Committee noted that it was important to consider the proposed definition of a network firm contained in the 8th directive. It was agreed that the Task Force should continue to monitor any such changes.

It was noted that the second part of the definition “an entity which is connected to the firm by means of common control, ownership or management” should be restructured. The Committee discussed what level of ownership would be necessary to conclude that a firm was part of a network. The Committee concluded that while it was probably not possible to draw a bright line, it would be useful if the Task Force developed some guidance in this area.

The Committee noted that while a network firm would not be in a position to influence the outcome of an audit there was an effect on independence in appearance. The Committee felt that the holding out as being part of a network contributed to the appearance issue and should be given greater emphasis in the background material. The Committee noted however, that some jurisdictions had encouraged small firms and sole practitioners to form associations to for example, share some technical resources and therefore improve quality. It is important that associations would not automatically be captured under the definition and background material for those reasons.

It was agreed that the Task Force should bring back a revised definition and background material for approval at the June 2005 meeting.

8. Forum

Mr. George presented a paper addressing the proposed content and format of a Forum to be held in October 2005.

It was noted that there might not enough time to address all of the matters noted in the proposal.

The Committee provided comment on the people who should be invited to the forum.

It was agreed that the Planning Committee would consider the feedback and present a detailed plan for approval and discussion at the June 2005 meeting.

9. Closing

Mr. George thanked all attending for their participation and closed the meeting.

10. Future Meeting Date

June 13-14, 2005 (Rome)

October 10-12, 2005 (Brussels)