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Agenda Item 5

Committee IFAC Ethics Committee
Meeting Location: Radisson SAS, Rome, Italy
Meeting Date: June 13-14, 2005

Equivalent Standards

Objectives of Agenda Item

1. To consider the content of “equivalent standards”.

Background

At its February 2005 meeting, the Committee discussed member body implementation of the Code. The Committee agreed it was appropriate to develop a paper that would describe 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. The Committee further agreed that the Planning Committee should develop 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.

Discussion

In discussing the meaning of equivalent standards, the Committee agreed that while national standards may differ in detail from the Code their application should yield the equivalent of a similar result as the IFAC standards.

In discussing which parts of the Code a member body would have to incorporate to conclude that 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 or 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 concluded 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.

Agenda Paper 5-A contains the ED of the *Code of Ethics of Professional Accountants*. In the paper, all of the "prohibitions" and essential elements have been identified by underlining the text. There is some repetition in the underlined paragraphs, especially in ¶290 with the statement that if the threat is other than clearly insignificant safeguards should be considered and applied to reduce the threat to an acceptable level.

The Committee concluded in February that while national Codes might differ in detail their application should achieve a similar result. Therefore, while the requirements and essential procedures contained in the Code have been identified by underlined text, this is not meant to imply that these exact words would need to be incorporated. Rather the view is that the content should be equivalent.

Conceptual Framework

The conceptual framework is described in ¶100.2 (requirement to use the conceptual framework), ¶100.4 (fundamental principles), ¶100.5-7 & 8 (description of conceptual framework), ¶100.10 (description of five categories of threats) and ¶100.15 (requirement to consider views of a reasonable and informed third party).

Action requested

Committee members are asked to consider whether these requirements need to be incorporated to achieve equivalent standards.

Types of requirements

At the February meeting, the Committee concluded that national standards should incorporate all of the prohibitions in the Code, irrespective of how the prohibitions were worded in the Code.

There are several types of such requirements as identified in Agenda Paper 5-A:

1. The accountant should not do something – for example "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" ¶100.2
2. The accountant should consider doing something – for example "a professional accountant should also consider the need to maintain confidentiality of information within the firm or employing organization." ¶140.4 and "In deciding whether to disclose confidential information, professional accountants should consider the following points..." ¶140.8
3. A statement that the accountant is required to do something – for example "a professional accountant in public practice who provides an assurance service is required to be independent of the assurance client" ¶280.2 and "Therefore, members of the assurance team are responsible for identifying any such persons [close relationships other than immediate or close family] and for consulting in accordance with firm procedures." ¶290.138
4. A statement that the accountant can only do something is certain safeguards are put in place – for example "if a member of the assurance team receives, by way of, for example, an inheritance, gift or, as a result of a merger, a direct financial interest or a material indirect

financial interest in the assurance client, a self-interest threat would be created. The following safeguards should be applied to eliminate the threat or reduce it to an acceptable level...”

¶290.106

5. A statement of an expectation of a professional accountants – for example “A professional accountant in business is expected, therefore, to encourage an ethics-based culture in an employing organization that emphasizes the importance that senior management places on ethical behavior.” ¶300.5

Action requested

Committee members are asked to consider the above examples and consider whether these requirements need to be incorporated to achieve equivalent standards.

Inadvertent violations

Several paragraphs in the Code refer to inadvertent violations.

- ¶100.8 states that an inadvertent violation of a provision in the Code may not compromise compliance with the fundamental principles provided the violation is corrected promptly and necessary safeguards are applied;
- ¶290.13 states that an inadvertent violation of the independence requirements would not compromise independence provided the firm has appropriate quality control policies and procedures in place to promote independence and the violation is corrected promptly and necessary safeguards are applied
- ¶290.110 and ¶290.140 also refer to inadvertent violations

An argument could be made that this paragraphs need to be incorporated into national standards because, without these paragraphs, the approach would be more rules based than principles based. Others may consider that incorporating these paragraphs is not necessary because it would be an example of a “Code plus”.

Action requested

Committee members are asked to consider whether consider whether these requirements need to be incorporated to achieve equivalent standards.

Clearly insignificant

¶290.14 states that a matter should be considered clearly insignificant only if it is deemed to be both trivial and inconsequential. This thought was included to make it clear that safeguards needed to be considered and applied for all but the most insignificant threat.

Action requested

Committee members are asked to consider whether this paragraph needs to be incorporated to achieve equivalent standards.

Examples that may create a threat

Several paragraphs state that certain situations may create a threat and therefore in such circumstances the significance of the threat should be evaluated. For example:

- ¶290.115 – If the retirement benefit plan of a firm, or network firm, has a financial interest in a financial statement audit client a self-interest threat may be created. Accordingly, the significance of any such threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.
- ¶290.136 – When an immediate family member of a member the assurance team is an employee in a position to exert direct and significant influence over the subject matter of the engagement, threats to independence may be created.
- ¶290.143 – If a member of the assurance team, partner or former partner of the firm joins the client the significance of the threat should be evaluated and, if other than clearly insignificant, safeguards should be applied.
- ¶290.152 – Using the same senior personnel on an assurance engagement over a long period of time may create a familiarity threats – the significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied to reduce the threat to an acceptable level.

It could be argued that it is not necessary to incorporate these requirements into national requirements because it would be covered under the general requirement to evaluate threats and apply safeguards to reduce threats that are other than clearly insignificant to an acceptable level. A counter argument would be that these examples should be incorporated because these examples are contained in the Code because it is likely that a threat will be created. For example, without the ¶290.143 an accountant might not think it necessary to evaluate any threats that might be created is a partner of the firm joins an assurance client.

Action requested

Committee members are asked to consider whether consider whether these requirements need to be incorporated to achieve equivalent standards.

Examples that do not create a threat

Some paragraphs provide examples of situations where a threat would not be created:

- ¶290.16 - A loan, or a guarantee of a loan, from an assurance client that is a bank or a similar institution, to a member of the assurance team or their immediate family would not create a threat to independence provided the loan, or guarantee, is made under normal lending procedures, terms and requirements.

- ¶290.133 - The purchase of goods and services from an assurance client by the firm (or from a financial statement audit client by a network firm) or a member of the assurance team would not generally create a threat to independence providing the transaction is in the normal course of business and on an arm's length basis.
- ¶290.198 Legal services to support a financial statement audit client in the execution of a transaction (e.g., contract support, legal advice, legal due diligence and restructuring) may create self-review threats; however, safeguards may be available to reduce these threats to an acceptable level. Such a service would not generally impair independence, provided that: Members of the assurance team are not involved in providing the service; and..."

The construction is such that it is not clear whether, for example, independence would be impaired (under ¶290.198) if the services were provided by members of the assurance team, or rather whether a threat would be created but it could be mitigated by appropriate safeguards.

Action requested

Committee members are asked to consider the examples provided – consider whether they think the examples are in effect prohibitions and as such should be incorporated to achieve equivalent standards.

Consideration of safeguards

Paragraph 350.4 states that the professional accountant should consider whether certain safeguards should be applied:

- ¶350.4 As the real or apparent threats to compliance with the fundamental principles do not merely arise from acceptance of an inducement but, sometimes, merely from the fact of the offer having been made, additional safeguards should be adopted. A professional accountant in business should assess the risk associated with all such offers and consider whether the following actions should be taken:
- (a) Where such offers have been made, immediately inform higher levels of management or those charged with governance of the employing organization;
 - (b) Inform third parties of the offer – for example, a professional body or the employer of the individual who made the offer; a professional accountant in business should, however, consider seeking legal advice before taking such a step; and
 - (c) Advise immediate or close family members of relevant threats and safeguards where they are potentially in positions that might result in offers of inducements, for example as a result of their employment situation; and
 - (d) Inform higher levels of management or those charged with governance of the employing organization where immediate or close family members are employed by competitors or potential suppliers of that organization.

Action requested

Committee members are asked to consider the example and consider whether it is in effect a requirement and, as such, should be incorporated to achieve equivalent standards.

Examples

At the February meeting, the Committee concluded that all of the examples contained in the Code should be incorporated to achieve equivalent standard (assuming that professional accountants belonging to a member body perform the relevant service).

Action requested

Committee members are asked to consider all of the examples underlined in Agenda Paper 6-A and consider whether they should all be incorporated to achieve equivalent standards.

Cultural differences

At the February 2005 meeting, the Committee noted that the Code should be sensitive to cultural differences because it applies to all professional accountants who are members of a member body of IFAC. The preface to the proposed Code contains the following statement:

“A member body of IFAC or firm may not apply less stringent standards than those stated in this Code. However, if a member body or firm is prohibited from complying with certain parts of this Code by law or regulation, they should comply with all other parts of this Code.”

This addresses legal or regulatory differences that might prevent a member body from implementing all of the “requirements” in the Code.

Cultural differences might extend the provisions within the Code. For example close family members are defined as a parent, child or sibling that is not a dependant. In some cultures the concept of family might be significantly wider and include, for example, uncles and aunts. The Code, in effect gives recognition to this in ¶290.139, which requires consideration of relationships with people who are other than immediate and close family members.

In drafting the Code, the Committee is sensitive to possible cultural differences. Through the exposure process, obtains comment on any aspects of a proposal that might not be appropriate because of cultural differences.

Action requested

Committee members are asked to consider whether there are any aspects of cultural differences that should be recognized when determining which requirements of the Code should be implemented by a member body. If Committee members believe that such recognition is needed, they are asked to provide specific examples of requirements in the Code which, due to cultural differences, might not need to be implemented by a member body.

Material Presented

Agenda Paper 5	This Agenda Paper
Agenda Paper 5-A	Exposure Draft of Code marked-up to identify prohibitions and essential elements

Action Requested

1. Committee members are asked to consider the questions raised in this agenda paper.