



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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Agenda Item

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Board International Standards Board for Accountants

Meeting Location: AICPA, New York, United States

Meeting Date: April 15-17, 2008

Drafting Conventions

Objectives of Agenda Item

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

Background

At its January 2008 meeting, the IESBA considered the proposals of the Task Force¹ 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 on March 3, 2008 to consider the direction of the IESBA. The proposals were presented at the CAG meeting on March 4, 2008 and the Task Force met again on March 31, 2008 to consider the input of the CAG and revise the document further.

The matters addressed by the Task Force are:

- Implications of the IAASB Clarity project on the Code;
- The use of the term “clearly insignificant” and its implications on the Code including the documentation requirements in Sections 290 and 291;
- The use of the word “consider”;
- Use of the words “examples” and “illustrates”; and
- How threats should be described in the Code.

Issues

Implications of IAASB Clarity Project

As discussed at the January 2008 IESBA meeting, 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-

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

written using the word “shall.” The intention was not to create any new requirements but, rather, to clarify the original intent.

This matter was discussed with the CAG. A CAG member noted that the IAASB use of the term “shall” denotes a specific meaning and questioned whether the IESBA would be using the same meaning. The amended preface to the ISAs, paragraphs 16 and 17, states:

“The requirements of each ISA ... are 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 procedures would be ineffective.”

The Task Force has considered this matter and is of the view that, in the Code, the use of “shall” denotes a mandatory requirement. The Task Force therefore proposes that the firm time “shall” is used in the Code it will be footnoted as follows:

“Shall” as used in this Code denotes a requirement. A professional accountant or firm is not permitted to depart from a requirement under any circumstances.

Clearly Insignificant

As agreed at the October IESBA meeting, the Task Force has eliminated the use of the term “clearly insignificant”, has added a definition of acceptable level and has clarified the documentation requirement.

The following documentation requirement was discussed with the CAG:

“Documentation is not, in itself, a determinant of whether a firm is independent. International auditing standards require documentation of (i) conclusions regarding compliance with independence requirements and (ii) any relevant discussions that support those conclusions. When threats to independence are identified that require the application of safeguards, the documentation shall also describe the nature of those threats and the safeguards applied to eliminate the threats or reduce them to an acceptable level.”

A CAG member noted that the Code currently requires documentation when the threats are above the level of clearly insignificant and the proposed revision would only require documentation when the threats were above an acceptable level. The CAG member expressed the view that the proposed change would, therefore, reduce documentation for situations that were “at the margin” – that is above clearly insignificant but at an acceptable level. The Task Force considered this matter and is of the view that if a matter was “at the margin” there would be discussions that would support the conclusion that the

threat was at an acceptable level and, would therefore, be documented under the ISA requirement.

A CAG member also noted that the proposed drafting would only require documentation of the conclusion and relevant discussions if the professional accountant was conducting an ISA audit. The member noted that an accountant that complied with the Code, but did not perform an ISA audit would not be required to document the conclusion. The Task Force considered this matter. The Task Force noted that when the Board issued the independence requirements in November 2001, the Code stated:

“When threats to independence that are not clearly insignificant are identified, and the firm decides to accept or continue the assurance engagement, the decision should be documented. The documentation should include a description of the threats identified and the safeguards applied to eliminate or reduce the threats to an acceptable level.”

In November 2001 there was no documentation requirement regarding independence in the ISAs.

The Task Force has considered this matter and is of the view that it is appropriate that the Code require documentation of the conclusion and the relevant discussions that support that conclusion. The Task Force, therefore, proposed that section 290 contain the following documentation requirement:

“Even though documentation is not, in itself, a determinant of whether a firm is independent, conclusions regarding compliance with independence requirements, and any relevant discussions that support those conclusions, shall be documented, in the same way as a professional accountant documents such matters under international standards on auditing. Documentation of independence conclusions and related discussions prepared to meet the requirements of international standards on auditing will also meet this requirement. When threats to independence are identified that require the application of safeguards, the documentation shall also describe the nature of those threats and the safeguards applied to eliminate them or reduce them to an acceptable level.”

In eliminating the term “clearly insignificant”, the Task Force has reviewed the description of the conceptual framework approach and its application.

Consider vs evaluate and determine

As agreed at the January 2008 IESBA meeting, the Task Force has reviewed the Code for the use of the term “consider” and proposes changes consistent with the following principles of drafting:

- “Consider” will be used where the accountant is required to think about several matters – for example ¶100.17 “When initiating either a formal or informal conflict resolution process, a professional accountant shall *consider* the

following, either individually or together with others, as part of the resolution process”

- “Evaluate” will be used when the accountant has to assess and weigh matters as in “the significance of the threat should be evaluated” – for example ¶100.6 “A professional accountant shall take qualitative as well as quantitative factors into account when *evaluating* the significant of a threat.”
- “Determine” will be used when the accountant has to conclude and make a decision – for example ¶290.216 “The firm shall also determine whether the overdue fees might be regarded as being equivalent to a loan to the client . . .”

Threats

At its October 2007 meeting, the IESBA noted that the Code is not clear in how it describes threats. In some cases, it states that a particular relationship *may* create a threat and then states that the significance of *the* threat should be evaluated. It was noted that if a matter *may* create a threat, it would be more logical to then determine whether a threat is created and, if so, require the significance of *the* threat to be evaluated. In addition, in some instances, the Code states that a particular matter may create a threat, but in the view of some IESBA members the particular matter does create a threat and, therefore, stating that a threat may be created in those situations is not correct and potentially weakens the Code. Other IESBA members were of the view that it was important to state that a threat may be created because this requires the professional accountant to think about whether a threat is created. IOSCO raised this matter in its response to the 2006 exposure draft.

While the Code describes the different categories of threats (for example, self-review, self-interest, etc.) it does not describe what is meant by a “threat” or how a threat is created. The Task Force believes that to clarify when a threat is or may be created, it would be helpful to address the question of “what creates a threat.” The Task Force has developed the following description of a threat:

“Threats may be created by a broad range of relationships or other facts and circumstances that could compromise a professional accountant’s compliance with the fundamental principles of this Code.”

This proposed description would require an evaluation by the accountant in each situation in which the Code says that a given relationship or circumstance creates a threat. That evaluation would center on the significance of the threat and whether the relationship or circumstance that *could* compromise the accountant's ability to comply with the fundamental principles actually *would* compromise his or her ability.

If a threat is described in this manner (i.e., created by relationships or other circumstances that *could* compromise a professional accountant’s ability to comply with the fundamental principles), many of the relationships and circumstances described in the Code would create a threat, the significance of which would need to be evaluated. Accordingly, with this description the example of circumstances in 200.4-8 are examples

that do create a threat and the Task Force, therefore, proposes deleting the word “may” in these paragraphs.

Five Categories of Threats

The Task Force also considered the descriptions of the five categories of threats. The conceptual framework approach was first incorporated into the Code in November 2001 in relation to independence (Section 8 as it then was). The threats were, therefore, described in terms of threats to independence. The description in the current Code of the categories of threats is shorter and more general, crafted to address the more general application of threats to compliance with all of the fundamental principles. As discussed at the January 2008 meeting, the Task Force believes the clarity of the Code and the understandability of each of the threats would be improved by refining the description of each of the five categories of threats.

The Task Force proposes the following descriptions, which appear in paragraph 100.10.

- (a) Self-interest threat - the threat that a professional accountant’s financial or other interests will inappropriately influence the professional accountant’s professional judgment or behavior;
- (b) Self-review threat - the threat that a professional accountant will not appropriately re-evaluate a previous judgment or service that requires re-evaluation because the professional accountant, or another individual within the professional accountant’s firm or employing organization, was responsible for the previous judgment or service. ;
- (c) Advocacy threat - the threat that a professional accountant who promotes a client’s or employer’s position will do so to the point that the professional accountant’s objectivity is compromised;
- (d) Familiarity threat - the threat that due to a long or close relationship with a client or employer, a professional accountant is too sympathetic to the interests of the client or employer or too accepting of the work of the client or employer; and
- (e) Intimidation threat - the threat that a professional accountant will be deterred from acting objectively by pressures, actual or perceived, because of the reputation of a client, employer, or others, or their attempts to exercise undue influence over the professional accountant.

Effective Date

The IESBA discussed this matter at its January 2008 meeting. It concluded that an effective date of approximately 18 months after approval with no transitional provisions would likely strike the right balance between requiring timely adoption and providing sufficient time for member adoption.

Material Presented

Agenda Paper 3

This Agenda Paper

Agenda Paper 3-A
Agenda Paper 3-B

Draft Revised Code
Draft Explanatory Memo

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 they are encouraged to provide any comments they might have directly to staff.