



**INTERNATIONAL FEDERATION  
OF ACCOUNTANTS**

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**Agenda Item**

**C**

**Board** Ethics Consultative Advisory Group

**Meeting Location:** Intercontinental, Toronto, Canada

**Meeting Date:** September 3, 2008

**Drafting Conventions**

**Objectives of Agenda Item**

1. To discuss the issues and provide feedback to the Task Force.

**Background**

At its March 2008 meeting the CAG considered proposals related to the Drafting Conventions project and CAG members provided feedback to the Task Force. The Task Force considered the input received and presented a draft to the IESBA at its April 2008 meeting. Agenda Paper C-1 provides extracts from the minutes of the March 2008 CAG meeting related to the drafting conventions project and describes how the Task Force and the IESBA responded to CAG members' comments.

The IESBA did not approve the exposure draft at its April meeting and held a conference call in May before approving the exposure draft at its June meeting. The exposure draft comment period ends on October 15, 2008. The Task Force plans to meet in early November to consider comments received. At the November 24, 2008 CAG meeting, the Task Force will present an overview of the comments received and an indication of how it intends to address the comments. The Task Force will meet after the CAG meeting to consider input received from CAG members and the IESBA will discuss the topic at its December meeting.

The matter is on this September CAG agenda to provide CAG members with the opportunity to discuss certain aspects of the exposure draft and provide some preliminary input to the Task Force. It will be beneficial to the Task Force to have an understanding of the preliminary views of CAG members as it considers the detailed exposure draft comments. In addition, CAG members who will be involved in preparing a response to the exposure draft will have the opportunity to ask questions regarding the content of the exposure draft.

## Issues

### *Temporary Departure from a Requirement*

At the March 2008 CAG meeting, a member noted that the IAASB use of the word “shall” denotes a specific meaning and questioned whether the IESBA would be using the meaning in the same way as in the ISAs. The IESBA considered this comment and determined that it was appropriate for the Code to explain what is meant by the use of the word “shall.” The IESBA determined that this should be described as follows:

“The use of the word “shall” in this Code imposes a requirement on the professional accountant or **firm** to comply with the specific provision in which “shall” has been used. Compliance is required unless prohibited by law or regulation or an exception is permitted by this Code.” ¶100.4

In developing this description, the IESBA considered whether the Code should provide that in exceptional circumstances it might be appropriate to depart from a requirement in the Code. The IESBA recognized that it is impossible to anticipate all circumstances faced by professional accountants when rendering a professional service and concluded that there may be exceptional and unforeseen circumstances in which the application of a specific requirement in the Code may result in an outcome that a reasonable and informed third party would not regard as being in the interest of the users of the output of the accountant's professional services. Accordingly, the IESBA is proposing to include guidance in paragraph 100.11 of the Code (the text of which is included in the appendix to this agenda paper) under which in exceptional and unforeseen circumstances that are outside the control of the professional accountant, the firm or employing organization, and the client, the professional accountant may judge it necessary to depart temporarily from a specific requirement. Such a departure would only be acceptable if all of the following conditions are met:

- The professional accountant discusses the matter with those charged with governance. The discussion shall include the nature of the exceptional and unforeseen circumstance, the fact that the circumstance is outside the control of the relevant parties, why in the professional accountant's judgment it is necessary to depart temporarily from a specific requirement in the Code, and any safeguards that will be applied;
- The professional accountant documents the matters discussed with those charged with governance;
- The nature of the departure and the reasons for the departure are appropriately disclosed to the users of the output of the professional services; and
- The professional accountant complies with the requirements of the Code at the earliest date that compliance can be achieved.

In addition, the exposure draft states that the professional accountant may wish to discuss the matter with the relevant regulatory authority. If the accountant has such a discussion, the exposure draft requires the substance of the discussion to be documented.

The IESBA is of the view that a departure should only occur in exceptional (i.e., rare and unusual) and unforeseen circumstances. For example, the IESBA considered the requirement that a key audit partner on a public interest entity audit client rotate off the audit engagement team after seven years. The Code provides that a partner whose continuity is especially important to audit quality may be permitted an additional year on the audit team. The IESBA is of the view that in exceptional circumstances it might be in the interest of the users of the audit report if a key audit partner were permitted to remain on the team for a period longer than one year.

Such might be the case if an initially planned rotation did not occur because of the unexpected death of the successor partner at the beginning of year eight and, thus, under the provisions of the existing Code, the incumbent partner remained on the team for one additional year, during which the firm identified another successor. That process included the firm making the necessary arrangements for the identified successor to take over as the key audit partner, including obtaining a visa and a license to practice in the particular jurisdiction, all of which took one year to achieve. However, at the end of the additional year and before the second successor partner assumed the key audit partner position, the partner unexpectedly left the firm and there was no other partner who could assume the key audit partner position before the additional year expired. In the absence of a departure from the strict requirement in the Code that provides only for one additional year on the engagement team in such circumstances, the only alternative is for the firm to resign from the audit engagement. A resignation under these circumstances could result in significant difficulties for the client and other users of the firm's audit report and, among other things, might lead to the client's failure to meet regulatory reporting requirements and other users to delay their decision-making regarding whether to invest in or lend money to the client.

The IESBA is of the view that in such circumstances it is in the interest of the users of the audit report if the incumbent key audit partner is permitted to remain temporarily on the audit team while the firm acts quickly to install another individual to serve as the key audit partner. For the departure from the Code to be acceptable, however, the matter shall be discussed with those charged with governance, the nature of the discussions shall be documented, the nature of the departure and the reasons for the departure shall be appropriately disclosed to the users of the audit report, and, in this example, a successor partner shall be put in place at the earliest date possible.

A departure is only acceptable if the circumstances are exceptional and unforeseen and are outside the control of the professional accountant, firm or employing organization, and the client. A departure cannot occur if compliance is possible but would be inconvenient to the professional accountant, firm, employing organization or client.

CAG members are asked to consider the following:

Do you agree that the Code should contain a provision that permits an exception to compliance with a requirement set out in the Code?

If you believe that the Code should contain a provision that permits an exception to compliance, are the conditions under which the exception would apply appropriate? Should there be additional or fewer conditions and, if so, what are they?

Are there any other circumstances where you believe a departure from a requirement in the Code would be acceptable? For example, should an event that is within the control of one of the relevant parties (such as a merger or acquisition by the client) qualify for an exception?

#### *Other Issues*

As previously discussed with the CAG, the exposure draft also proposes the following changes:

- *Threats* – Revising the description of the threat and the descriptions of each of the five categories of threat (¶100.13);
- *Clearly insignificant* – Eliminating the reference to “clearly insignificant” in favor of “acceptable level” and providing guidance on what is meant by an “acceptable level” (illustrated in ¶100.2);
- “*Consider*”, “*evaluate*” and “*determine*” – Changing the Code to be consistent with the following principles of drafting:
  - “Consider” will be used where the accountant is required to think about several matters;
  - “Evaluate” will be used when the accountant has to assess and weigh the significance of a matter; and
  - “Determine” will be used when the accountant has to conclude and make a decision.

The Appendix to this Agenda Paper contains relevant extracts from the exposure draft.

CAG members are asked to consider whether there are any additional matters they wish to raise on the above noted matters.

### **Material Presented**

Agenda Paper D  
Agenda Paper D.1

This Agenda Paper  
Draft Revised Code

The exposure draft can be downloaded from the IFAC website on <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0116>

### **Action Requested**

1. CAG members are asked to review the issues and the questions outlined in the paper and provide input to the Task Force.
2. CAG members are invited to raise any other questions they might have related to the exposure draft.

## Appendix Extract from the Exposure Draft

### *Temporary Departure from a Requirement in the Code*

100.11 In exceptional and unforeseen circumstances that are outside the control of the professional accountant, the firm or employing organization, and the client, the application of a specific requirement in the Code may result in an outcome that a reasonable and informed third party would not regard as being in the interest of the users of the output of the professional services. In such circumstances, the professional accountant may judge it necessary to depart temporarily from that specific requirement. Such a departure would be acceptable only if all of the following conditions are met:

- The professional accountant discusses the matter with **those charged with governance**;<sup>\*</sup> the discussion shall include the nature of the exceptional and unforeseen circumstance, the fact that the circumstance is outside the control of the relevant parties, why in the professional accountant's judgment it is necessary to depart temporarily from a specific requirement in the Code, and any safeguards that will be applied;
- The professional accountant documents the matters discussed with those charged with governance;
- The nature of the departure and the reasons for the departure are appropriately disclosed to the users of the output of the professional services; and
- The professional accountant complies with the requirements of the Code at the earliest date that compliance can be achieved.

The professional accountant may wish to discuss the matter with the relevant regulatory authority. If the accountant has such a discussion, the substance of that discussion shall be documented.

### *Documentation*

290.29 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. Documentation of independence conclusions and related discussions prepared to meet the requirements of international standards on auditing will 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.

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\* See Definitions.

### *Threats*

100.13 Threats may be created by a broad range of relationships and circumstances. When a relationship or circumstance creates a threat, such a threat could compromise, or could be perceived to compromise, a professional accountant's compliance with the fundamental principles. A circumstance or relationship may create more than one threat, and a threat may affect compliance with more than one fundamental principle. Many threats fall into the following categories:

- (a) Self-interest threat - the threat that a financial or other interest will inappropriately influence the professional accountant's judgment or behavior;
- (b) Self-review threat - the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made or service performed by the professional accountant, or by another individual within the professional accountant's firm or employing organization, on which the accountant will rely when forming a judgment as part of providing a current service;
- (c) Advocacy threat - the threat that a professional accountant will promote a client's or employer's position 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 will be too sympathetic to their interests or too accepting of their work; and
- (e) Intimidation threat - the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the professional accountant.

Parts B and C of this Code explain how these categories of threats may be created for professional accountants in public practice and professional accountants in business, respectively. Professional accountants in public practice may also find Part C relevant to their particular circumstances.

### *Clearly Insignificant*

100.2 This Code is in three parts. Part A establishes the fundamental principles of professional ethics for professional accountants and provides a conceptual framework for applying those principles. Professional accountants shall use professional judgment in applying this conceptual framework. The framework requires the professional accountant to:

- (a) Identify threats to compliance with the fundamental principles;
- (b) Evaluate the significance of the threats identified; and
- (c) Apply safeguards, when necessary, to eliminate the threats or reduce them to an **acceptable level**.<sup>\*</sup> Safeguards are necessary when the professional

accountant determines that the threats are not at a level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised.