

IESBA Staff Questions and Answers

Implementing The Code Of Ethics

December 2010

This Questions and Answers (Q&A) publication is issued by the staff of the International Ethics Standards Board for Accountants (IESBA) to assist member bodies and others as they adopt and implement The Code of Ethics for Professional Accountants (the Code) issued by the International Ethics Standards Board for Accountants (IESBA) in July 2009.

This publication does not amend or override the Code, the text of which alone is authoritative. Reading this Q&A is not a substitute for reading the Code. This Q&A is not meant to be exhaustive and reference to the Code itself should always be made. This publication does not constitute an authoritative or official pronouncement of the IESBA.

Background

The Code issued by the IESBA in July 2009 became effective on January 1, 2011, subject to some specific transitional provisions. The IESBA staff has developed materials to support the implementation of the Code. These materials include: PowerPoint presentations providing an overview of the Code and in-depth discussions of the independence provisions; an overview of the independence provisions; comparisons of the 2009 Code and the 2006 Code; and a template that can be used to compare the provisions in the Code with the provisions in another jurisdiction.

IESBA staff received some questions from member bodies and others as they went through their adoption and implementation processes. This document contains some of those questions and answers.

Questions and Answers

Application of the Conceptual Framework Approach

Q1. Under the conceptual framework approach in the Code, can a professional accountant apply safeguards to avoid having to comply with a prohibition in the Code? For example, can an interest or relationship that is prohibited under the Code be entered into if the professional accountant applies safeguards?

No. The prohibitions in the Code are derived from the application of the conceptual framework. Therefore, when an interest or relationship is prohibited, the IESBA has already considered whether safeguards can be effective in eliminating the related threat or reducing it to an acceptable level. Accordingly, the professional accountant may not apply safeguards, regardless of how rigorous they may be thought to be, to overcome the requirement to comply with a prohibition in the Code.

- Q2. Can an audit firm apply safeguards to enable it to avoid complying with a provision that prohibits a non-assurance service? Does it make a difference if the firm is a small audit firm?**

The answer to both questions is no. Refer to the answer to Question 1 above. The significance of a threat does not differ just because an audit firm is a small firm. While the Board is sensitive to the issues faced by small firms, it concluded that other than the exception to partner rotation in paragraph 290.155, the requirements in the Code should not differ based on the size of a firm.

- Q3. If an interest or relationship with the audit client is not prohibited under the Code (e.g., the Code does not address it or there is no provision in the Code that would apply by analogy), does that mean the interest or relationship is automatically permitted?**

No. Under the conceptual framework approach in the Code, the interest or relationship must be evaluated to determine whether it creates any threats to independence. If any threats created are not at an acceptable level, safeguards must be applied to eliminate the threats or reduce them to an acceptable level. Only then would the interest or relationship be permitted.

- Q4. For interests or relationships that are not prohibited by the Code, could the application of the conceptual framework approach result in a decision that the interest or relationship should not be entered into?**

Yes. The conceptual framework approach requires a rigorous analysis of the threats that may be created by the interest or relationship and an assessment of whether safeguards are available and can be applied to eliminate the threats or reduce them to an acceptable level. If that cannot be achieved, the interest or relationship should not be entered into. Accordingly, while the conceptual framework approach helps the professional accountant to determine how best to meet the objectives of the fundamental principles set out in the Code, it can also demonstrate that an interest or relationship should not be entered into because the threat that would be created would be such that no safeguards could reduce it to an acceptable level.

- Q5. The 2009 Code does not use the term "clearly insignificant," which was used in the 2006 Code. How does this affect the evaluation of threats and application of safeguards when applying the conceptual framework approach?**

In the 2006 Code, the term "clearly insignificant" was used to establish the starting point for determining which threats (i.e., threats that were not clearly insignificant) might require the application of safeguards. Under both the 2006 and 2009 Codes, a threat that is not at an acceptable level requires the application of safeguards to eliminate the threat or reduce it to an acceptable level before the interest or relationship that creates the threat can be deemed acceptable. Accordingly, the change simplified the application of the conceptual framework approach, without changing the requirement that threats that are not at an acceptable level be eliminated or reduced to an acceptable level by the application of safeguards.

- Q6. Certain paragraphs in the Code provide a list of safeguards that could be applied. Are these lists all-inclusive or are there other safeguards that might be effective in the particular circumstances?**

Where the list of safeguards is preceded by wording such as "examples of such safeguards include," the list is not all inclusive but merely contains examples of safeguards that the IESBA believes could be effective in the specific circumstance. Other safeguards might also be effective. Judgment would be required to determine the effectiveness of any safeguards in each circumstance. However, where the safeguards are prescribed, as in paragraph 290.222, those safeguards must be applied.

Relevance of Part C to a Professional Accountant in Public Practice

- Q7. Paragraph 100.3 states that “Professional accountants in public practice may also find Part C relevant to their particular circumstances.” What are examples of circumstances for which a professional accountant in public practice might find it useful to refer to the guidance in the Code for professional accountants in business?**

Professional accountants in public practice who are partners or employees of firms may face circumstances that are similar to those that professional accountants in business might face when working for their employers. Some examples include (a) receiving an offer of inducement in an attempt to unduly influence the actions or decisions of the professional accountant in public practice, (b) being eligible for a bonus, the value of which could be affected by decisions made by the professional accountant in public practice, (c) being provided with insufficient time to properly perform relevant duties, and (d) being pressured to be associated with financial information that materially misrepresents the facts.

Pre- or Post-issuance Review When Total Fees Exceed 15%

- Q8. Under paragraph 290.222 a pre- or post-issuance review of the audit engagement is required to be conducted by a professional accountant who is not a member of the firm. It could be difficult to engage an outside professional accountant to perform that review because of concerns that the review would expose the accountant to liability. Is there any alternative in that situation?**

No. The IESBA concluded that such a review, which must be equivalent to an engagement quality control review, is a necessary safeguard when total fees from an audit client that is a public interest entity exceed 15% of the firm's total fees for two consecutive years. Most firms have insurance policies that provide them with practice liability protection and many of those policies cover outside professional accountants who provide services to the firm. Firms might also consider indemnifying the outside professional accountant to address concerns about exposure to liability. Under either arrangement, the accountant performing the review would need to comply with the confidentiality requirements in the Code with respect to the firm and the firm's audit client.

- Q9. When determining whether total fees from a public interest entity audit client exceed 15% of the firm's total fees, how should the calculation be made? Should the firm include in the calculation all fees charged for all services rendered to the audit client (i.e., not just audit fees) and all fees charged for all services rendered to all clients?**

Yes.

Definition of Key Audit Partner

- Q10. Would a tax partner who participates on the audit team be considered a key audit partner?**

Generally, no. A tax partner is not an audit partner and, therefore, would typically not meet the definition of a key audit partner. However, judgment should be applied in determining whether a tax partner on the audit team functions in substance as an audit partner. If so, the tax partner would meet the definition of a key audit partner and be subject to the provisions in the Code that apply to key audit partners.

Related Entities

- Q11. When applying paragraph 290.27 in a situation involving an audit client that is not a listed entity where the client does not control the related entity (e.g., a company over which the client has significant influence), should a firm consider all interests and relationships that it has with that related entity, or just the interest or relationship that caused the audit team to believe that the related entity is relevant to its evaluation of the firm's independence from the client?**

All interests and relationships with the related entity should be considered once the audit team has concluded that the related entity is relevant to its evaluation of the firm's independence from the client.

Partner Rotation

- Q12. If a firm is unable to meet the partner rotation requirements because it does not have enough audit partners in the firm, paragraph 290.155 notes that partner rotation may not be an available safeguard. If a firm has determined that it is not possible to apply that safeguard, and the independent regulator in that jurisdiction has not provided an exemption from partner rotation in such circumstances, is there any other alternative for that situation?**

No. The board believes that partner rotation strikes the right balance between the objective of bringing a fresh set of eyes to the engagement and the objective of retaining a firm's institutional knowledge of the client to promote audit quality. The board concluded that other possible safeguards would not be effective in achieving the first objective.

Emergency Accounting and Bookkeeping Services

- Q13. The Code indicates that accounting and bookkeeping services can be provided to an audit client in emergency or other unusual situations where it is impractical for the**

client to make other arrangements and specified conditions are met. How would one determine whether a circumstance was an emergency or other unusual situation?

Given the self-review threats that are created by rendering such a service to an audit client, the Board intends this to be a high hurdle to meet. Whether a circumstance is an emergency or other unusual situation would depend on all of the relevant facts. However, it would likely involve a sudden and unexpected event that was not foreseeable and one that creates a situation that calls for immediate action. In that case, if it is impractical for the client to obtain the accounting and bookkeeping services from another provider, and other specified conditions are met, the audit firm may provide the services.

Taxation Services

Q14. Why does the 2009 Code contain more detailed guidance on tax services than the 2006 Code?

The Board revisited the guidance on taxation services and concluded that the 2006 Code did not adequately address the range of tax services that clients request or the threats that such services may create. The Board believes that the statement in the 2006 Code that tax services "are generally not seen to create threats to independence" is appropriate when the service is tax return preparation, provided management takes responsibility for the returns and any significant judgments made in their preparation. However, the Board concluded that this is not always the case for other tax services and decided to expand the guidance in the Code to convey this to assist professional accountants in meeting the objectives of the fundamental principles.

Q15. What is an example of tax advice where the effectiveness of the advice depends on a particular accounting treatment or financial statement presentation (paragraph 290.190) for which the audit team could have reasonable doubt as to its appropriateness?

Situations will vary depending on the taxing jurisdiction and judgment will be required. One example might be where the effectiveness of tax advice to deduct lease payments depends on the lease being treated as an operating lease for financial reporting purposes. In that case, the audit team will need to conclude without reasonable doubt that the operating lease treatment is appropriate for accounting purposes.

Q16. Paragraph 290.185 prohibits tax calculations of current and deferred taxes for the purpose of preparing accounting entries for a public interest entity audit client where the entries would be material to the financial statements. If the entries would not be material, could the firm provide the service without performing an evaluation of any threats that may be created by the service?

No. The fact that the service is not prohibited doesn't automatically make it permitted. (Refer to the answer to Question 3.)

Effective Date

Q17. The 2009 Code provides a one-year delayed effective date for the additional independence provisions of the Code that apply because of the new definition of a public interest entity or because the related guidance in paragraph 290.26 captures entities that were not public interest entities under the 2006 Code. Does that delayed effective date have priority over the delayed effective dates that apply to the new non-assurance services and fees provisions?

Yes.

Services Involving the Extension of Audit Procedures

Q18. The 2009 Code does not include the statement that is in the 2006 Code that "services involving an extension of the procedures required to conduct a financial statement audit in accordance with International Standards on Auditing would not be considered to impair independence . . . provided that the firm's or network firm's personnel do not act or appear to act in a capacity equivalent to a member of audit client management." Does the absence of this statement mean that such a service is prohibited under the 2009 Code?

No. The IESBA believes that the statement continues to hold true. However, it is no longer necessary given the revised Code's description of certain internal audit activities, which does not include performing extended procedures as part of a financial statement audit, and its expanded guidance on management responsibilities, both in the section dealing with internal audit services and in a new section dealing with management responsibilities.

Provision of IT Systems Services

Q19. A firm has been asked to implement an IT system for a public interest entity audit client. Since the system will not form a significant part of the client's internal control over financial reporting and will not generate information that is significant to the client's accounting records or financial statements, the service is not prohibited under paragraph 290.206, which explicitly applies to public interest entity audit clients. Can the firm provide the service without performing an evaluation of any threats that may be created by the service?

No, an evaluation of any threats that may be created is still required. Paragraph 290.206 is a prohibitive provision. Just because a service is not prohibited under that paragraph doesn't mean it is automatically permitted. (Refer to the answer to Question 3.)

Providing a Modified Report

Q20. Paragraph 110.3 states that a professional accountant will be deemed not to be in breach of paragraph 110.2 if the professional accountant provides a modified report in respect of a matter contained in paragraph 110.2. Does paragraph 110.3 apply to professional accountants in business as well as professional accountants in public practice?

Yes. Section 110, and therefore paragraph 110.3, applies to all professional accountants, including professional accountants in business. Accordingly, if a professional accountant in business can utilize a form of reporting that in substance accomplishes the same thing as a modified report issued by a professional accountant in public practice, 110.3 would apply.

Self-interest Threat Example

Q21. Paragraph 200.4 states that a professional accountant discovering a significant error when evaluating the results of a previous professional service performed by a member of the professional accountant's firm is an example of a circumstance that creates a self-interest threat. The previous Code described this as a self-review threat. Why did the board change this?

A self-review threat is the threat that the professional accountant will not appropriately evaluate the results of the previous service and, for example, find any errors. However, once an error has been discovered, the professional accountant would need to address the error. The threat, therefore, is that the professional accountant might not do that because it is not in the accountant's self-interest (or the firm or employing organization's interest) to do so. Thus, upon discovery of the error, the threat that is created is a self-interest threat.

Financial Interests

Q22. Paragraph 290.116 requires the disposal of a financial interest received by way of an inheritance, gift, or as a result of a merger. Why must the firm, members of the audit team, and their immediate family dispose of such an interest immediately while individuals who are not members of the audit team are required to dispose as soon as possible?

The requirement to dispose immediately reflects the urgency of reducing or eliminating the self-interest threat created by such an interest so that the audit is not being conducted by those who have a financial stake in the outcome of the audit. Accordingly, if a member of the audit team or their immediate family member cannot dispose of the interest immediately, the individual should be removed from the audit team.

Valuation Services

Q23. Paragraph 290.180 states that a firm shall not provide valuation services to an audit client that is a public interest entity if the valuations would have a material effect, separately or in the aggregate, on the "financial statements on which the firm will express an opinion." Why is this term used and how is it different from "financial statements"?

The Code, in paragraph 290.27, states that when the audit client is a listed entity, references in the Code to audit client include related entities of the client unless otherwise stated. The term "financial statements on which the firm will express an opinion" is used to make it clear which financial statements should be used to make the materiality determination. In the case of the audit of a consolidated group, it is the consolidated financial statements of that group. In the case of a single entity, it is the financial statements of that single entity.

Contingent Fees

Q24. Paragraph 290.226(a) prohibits the charging of a contingent fee if the fee is charged by the “firm expressing the opinion on the financial statements” and the fee is material to that firm. Why is this term used and to which firm does it refer?

Paragraph 290.3 states that the term “firm” includes network firm unless otherwise stated. The term “firm expressing the opinion on the financial statements” is used to make it clear that, in a group audit situation, materiality should be measured against the firm itself, and not the network firms. Paragraph 290.226(b) addresses network firms.

Application of Section 291

Q25. Section 290 applies to audit and review engagements and provides additional requirements for entities that are public interest entities. Section 291 applies to other assurance engagements (i.e., non-audit assurance engagements) but does not provide any additional requirements for public interest entities. Which parts of Section 291 apply to an engagement to provide an “other assurance service” to a public interest entity?

Section 291 applies equally with respect to non-audit assurance clients that are public interest entities and those that are not public interest entities. There is no distinction in that section between the two types of non-audit assurance clients. If the client is one for which the firm also provides an audit or review service, the provisions of Section 290 would also apply.