

**Meeting:** IESBA CAG  
**Meeting Location:** New York  
**Meeting Date:** March 10, 2014

## Agenda Item

# E

### Emerging Issues and Outreach

#### Objectives of Agenda Item

1. To discuss recent developments internationally that may merit further consideration by the IESBA as emerging issues, and to receive CAG input on opportunities for IESBA outreach to CAG member organizations.

#### Background

2. At its March 2013 meeting, the IESBA set up a working group to explore and develop working processes for the Board's Emerging Issues and Outreach initiative. The aims of the initiative are two-fold:
  - a) To identify developments in the external environment around the world, outside of the Board's strategic planning process, that may have implications for the Board's strategy and work plan, require Board action or otherwise merit Board attention; and
  - b) To advise the Board on ways to enhance the effectiveness of the Board's outreach efforts, including with respect to the scope and focus of, and general approach to, its outreach activities.
3. At its December 2013 meeting, the Board finalized the working processes. At the same time, it agreed to establish a standing committee (the Emerging Issues and Outreach Committee, or EIOC) to oversee the activities in this area.
4. The Chair of the CAG was an observer with speaking rights to the original working group and continues in that role with respect to the EIOC.
5. The EIOC met via teleconference in January and February 2014 to consider relevant external developments and has identified the matters set out in Sections B-D(i) below for possible consideration by the Board at the April 2014 IESBA meeting.

#### Matters for CAG Consideration

##### A. Emerging Issues and Outreach Working Processes

6. For reference, the working processes and the EIOC's Terms of Reference as agreed by the Board are set out in Agenda Item E-1. The development of these working processes and Terms of Reference has benefited from input from the CAG Chair.

**Matter for CAG Consideration**

1. Representatives are asked if they have any suggestions for possible enhancements to the working processes in Agenda Item E-1.

**B. MG Rover Case**

7. The following summarizes the pertinent facts in the final report of the UK Financial Reporting Council's (FRC's) independent tribunal that issued its ruling on the MG Rover case in the UK in September 2013.<sup>1</sup> The FRC is the UK's and the Republic of Ireland's independent regulator responsible for promoting high quality corporate governance. Additional background information relating to the MG Rover case is set out in Agenda Item E-2.
8. MG Rover was a UK car manufacturer that entered administration in April 2005 with estimated losses of nearly £1bn and about 6,500 staff redundancies.
9. The MG Rover case relates to actions of Deloitte and one of its corporate finance partners in 2001 and 2002, and whether they breached the relevant ethical standards contained in the Institute of Chartered Accountants in England and Wales's (ICAEW's) Guide to Professional Ethics (GPE). The GPE is based on the IESBA Code. The allegations all related to corporate finance work rather than audit work and thus can be considered to concern practice work in general, rather than audit-specific matters.
10. The FRC's investigation centered on two particular transactions, Project Platinum and Project Aircraft. The FRC argued that in both transactions the consortium of four directors (the "Phoenix Four") that bought MG Rover were given an opportunity to make money for themselves at the expense of MG Rover thanks to advice provided by Deloitte.
11. Project Platinum related to the purchase of BMW's loan book. The loan book consisted of amounts due to MG Rover under existing finance contracts from customers who had bought vehicles from MG Rover. BMW originally planned to sell the loan book directly to MG Rover – which had £41m in an account as collateral for the loans. The Phoenix Four instead bought the loan book and sought to keep the profits for themselves.
12. The Project Aircraft scheme was designed to generate returns on tax losses incurred by MG Rover, which could be offset against profits made elsewhere in MG Rover. The Phoenix Four used the tax losses from MG Rover in another company they owned in which MG Rover had no interest. Deloitte has been granted rights to appeal against the six findings relating to Project Aircraft. The review of the case commenced in December 2013 and is expected to take six months to complete.
13. The FRC tribunal:
  - (a) Found that MG Rover was, although not listed, a "public interest company;"
  - (b) Found that every accountant should "consider the public interest when accepting any assignment" (whether or not in relation to a public interest company);

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<sup>1</sup> The final report of the tribunal can be accessed at: <http://www.frc.org.uk/News-and-Events/FRC-Press/Press/2013/September/FRC-publishes-Final-Report-of-Disciplinary-Hearing.aspx>.

- (c) Rejected Deloitte's contention that a corporate financier serves the public interest by properly advising his clients within the ICAEW Code; and
  - (d) Found that Deloitte was aware of the public interest and breached its obligations to consider the public interest before accepting or continuing the appointment.
14. The current IESBA Code includes a number of references to the public interest (see Appendix 1).
  15. There are frequent references to the public interest issue in the FRC report, but they do not conclusively, or consistently, set out exactly what Deloitte should have done to consider the public interest.
  16. There are a number of comments within the report from the tribunal which could be taken to imply that the tribunal was interpreting the public interest obligation in a much wider sense than indicated in the ICAEW Code (see relevant extracts from the ICAEW Code in Appendix 2 and a summary of the FRC's interpretation in Appendix 3).
  17. These comments include:
    - a) "...members ... owe duties not only to their clients or employers but also to the public. All have a duty to consider the public interest and its bearing on the work that they are doing and the potential or actual threats to their work.... We do not accept that, except in audit and reporting accountant work, the only duty that a member has is to his client provided that he is acting honestly and with integrity. It is this duty to consider the public interest that provides comfort to the client that matters are being dealt with properly and with integrity. It is however something which might put a chartered accountant at a disadvantage in corporate finance and other matters as against other parties who are not members of the ICAEW."
    - b) "A corporate financier, [the respondent] said, provides support for commerce by giving best advice to his or her client, not by assuming the role of the market or regulators or government and deciding which bidder in a corporate transaction has the public interest on their side. We do not accept this to be the position. It suggests that the Respondents in the case of Project Platinum had no obligation to consider the public interest..."
    - c) "MG Rover was a public interest company ...In those circumstances the Respondents should have given consideration to the public interest when acting as they did and should have considered whether to accept or continue with their engagement in [the project]. They should have considered whether [the project] was in the public interest, their assessment should have been recorded in writing."
  18. The tribunal stated that "member firms, whether they are acting as auditors, corporate advisers or in any other capacity owe duties not only to their clients or employers but also to the public ... we [the tribunal] do not accept that the only duty that a member has is to his client provided that he is acting honestly and with integrity."
  19. There appears to be a suggestion that in relation to one of the two projects (Project Aircraft) the engagement itself may have been appropriate at one stage but at some stage it became apparent that some of the assets of MG Rover were going to be used to benefit the Phoenix Four. It is not suggested that such a result would have been in any way illegal but the tribunal held that at that point "Deloitte should have declined to continue their engagement."

20. Based on the findings it would appear that an accountant is under an obligation to set himself up as judge and jury as to the moral worth of a particular client or a particular transaction and is obliged to breach his contract when he decides a particular outcome is no longer in the public interest. This obligation apparently falls on every accountant but the tribunal does not explain how is an accountant to judge if he is in breach of this principle.
21. The FRC noted that “there is no evidence of the public interest having been considered adequately or at all.” However, guidance on record-keeping matters relating to the public interest is vague. The FRC has assumed that since there is no evidence on the file to prove that the public interest had been considered, it must not have been considered.
22. The ICAEW Code advises that “it may be in the best interests of the professional accountant to document the substance of the issue, the details of any discussions held, and the decisions made concerning that issue.”
23. However, apart from audit-related considerations and setting out the basis of determining fees, the ICAEW Code does not, and never has, required the documentation of ethical considerations.
24. Nevertheless, the report criticizes the lack of documentation in considering the public interest. This may suggest that, as far as the FRC is concerned, the notion that no record means no action or consideration is no longer just applicable to audit.
25. The GPE makes documentation discretionary. However, the tribunal was arguing that the firm should have considered documentation on how the public interest has been considered “in this context.”
26. One of the tribunal’s central contentions is that the main car company should have been considered to be a public interest entity (PIE). They cite, for example: “huge interest ...great support... from the public ... talk ...about the saving of a major car manufacturer...and large numbers of local jobs ... a great deal of political will...”
27. The ICAEW Code defines a PIE as a listed company or other entity deemed to be a PIE by law or regulation. Nevertheless the ICAEW Code does add (directly from the IESBA Code) that firms are encouraged to consider other entities with a wide range of stakeholders as PIEs. The tribunal was not applying a definition of a PIE, but stating that MG Rover was of public interest because of the wide range of stakeholders.
28. The ICAEW Code definition of a PIE is not strictly relevant as it relates only to assurance engagements. However, the tribunal is using the concept not to argue that a different set of rules should apply but that because the car company was a PIE, it should be regarded as a separate entity from the other companies owned by the Phoenix Four, on which Deloitte was also providing advice.
29. As a result of the MG Rover case, the ICAEW Ethics Committee is considering whether additional guidance is needed within its Code on how to consider the public interest and what the public interest means for the individual accountants.
30. The principal argument against issuing additional guidance is that of proportionality – issuing guidance in reaction to what may be a one-off use of the public interest as a disciplinary tool could suggest over-reaction and run the risk of institutionalizing comments in the tribunal’s report.

31. A further argument is that the current guidance on public interest is fit for purpose given the wide variety of circumstances, and any change would undermine the framework approach to ethical guidance. Ethical principles are subjective and unless a precise, rules-based approach is desired, there will inevitably be an element in which society's moral values will be relevant in deciding how fundamental principles are to be interpreted.
32. It is relatively straightforward to identify activity which would constitute an egregious breach of the public interest. However, in most cases, the degree to which the public interest may need to be elevated is highly judgmental.
33. As a result of the MG Rover case, the ICAEW is considering issuing guidance on:
  - (a) Recommending that its members consider whether there is a public interest aspect to their work (providing examples of suitable indicators);
  - (b) Drawing attention to the key relevant elements of the public interest framework; and
  - (c) Noting that if this indicates that there is more than one potential client, at least one of which has a public interest, then safeguards need to be applied such as proposing independent advice.

#### **Matters for CAG Consideration**

Without debating the merits of the MG Rover case or how one might interpret the meaning of public interest, Representatives are asked:

2. Whether there are actions, if any, the IESBA should consider taking as a result of the decisions reached in this case as they pertain to defining what is in the public interest; and
3. Whether there are other specific matters that should be taken into consideration in further reflecting on the implications of the case.

#### **C. Aggressive Tax Avoidance**

34. Much of the current tax regulations around the world were put in place at a time when value could be clearly attributed to each stage of a supply chain and the tax jurisdiction of the economic activity was predominantly the home market. In recent times, these lines have become blurred. A business does not require a physical presence in a country in order to operate and assets (such as people and capital) can be moved across international borders with ease. With goods and services being sold through complex supply chains, it is not always easy to identify where profit is created and whether a country is receiving its proper share of revenue. In addition, tax abatement or mitigation schemes, put in place by local governments or other public authorities to stimulate or encourage investment in specific regions or industries, are being exploited by large multinationals to lower their tax bill.
35. Companies engaging in aggressive tax avoidance justify their actions by pointing out that their actions are not illegal and they have a duty to shareholders to minimize their tax bills.

36. G20 countries are working together on how to address the aggressive tax avoidance issue and are aiming for an automatic<sup>2</sup> exchange of information (among G20 members) on tax-related matters by the end of 2015.
37. Legal tax planning by businesses should in principle be accepted as a legitimate means of minimizing expenses in the same way that they would be expected to reduce any other business cost to maximize profits and shareholder value. It is not unreasonable for corporations to make use of low tax rates, or other tax benefits, which countries offer to compete for foreign investment. However, concerns are raised when companies appear to be exploiting loopholes created by outdated tax laws to avoid paying the appropriate amount of tax. In this regard, prominent individuals, including but not limited to politicians, have raised concerns over the role of accountants in assisting firms as they pursue aggressive tax avoidance. Mr. Michael Izza, the ICAEW's chief executive officer, has in particular taken a strong stance on the role of accountants in assisting companies engaging in aggressive tax avoidance. He has stated on his blog the following:

*"As ICAEW Chartered Accountants, our code of ethics, which is the foundation for how we behave, is clear that we must do nothing to bring our profession into disrepute. Any members involved in aggressive tax planning... are doing exactly that, and are risking the reputation of the vast majority of our members who provide valuable and honest support to businesses and individuals and who want nothing to do with such (aggressive tax avoidance) schemes.*

*ICAEW Chartered Accountants should be trusted to abide by our Code of Ethics... any ICAEW Chartered Accountants who are engaged in (aggressive tax avoidance) schemes... need to look at themselves in the mirror and ask – am I upholding the honor and reputation of ICAEW Chartered Accountants and am I seen to be doing that? If the answer is no then they need to ask themselves whether they want to belong to our profession or not?"*

**Matter for CAG Consideration**

4. Do Representatives believe developments in this area warrant specific actions by the IESBA, other than ongoing monitoring? If so, what should these be?

**D. Other Matters for Consideration**

*(i) European Union (EU) Audit Reform*

38. On December 17, 2013, the EU Council announced that a preliminary agreement had been reached with the European Parliament on the framework of the EU audit reform. On December 18, 2013, the Committee of Permanent Representatives approved this agreement.

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<sup>2</sup> Automatic exchange of information involves the systematic and periodic transmission of "bulk" taxpayer information by the source country to the residence country concerning various categories of income (e.g. dividends, interest, royalties, salaries, pensions, etc.) It can provide timely information on non-compliance where tax has been evaded either on an investment return or the underlying capital sum even where tax administrations have had no previous indications of non-compliance.

39. Under the agreement, audit firms will be required to rotate every 10 years but public listed companies will be able to extend the audit tenure for another 10 years upon tender. In the case of joint audits the extension period will be up to 14 years.
40. The agreement also proposes a 70% cap on the fees earned for non-audit services rendered to an audit client. Therefore, an audit firm would not be able to tender for non-audit services worth more than 70% of the audit fee.
41. Member states will have the right to allow some tax and valuation services to be provided if they are immaterial and have no direct effect on the audited financial statements. Within the legislation there is still room for member states to diverge on major issues such as the list of prohibited non-audit services and the duration of the rotation.
42. According to Ernst & Young, the estimated cost to the EU economy of rotating the auditors of more than 30,000 PIEs could be more than €16bn (\$22bn).
43. This measure aims at limiting risk derived from conflicts of interest, when auditors are involved in decisions impacting the management of a company. It would also limit substantially the “self-review” risks for the auditors.
44. Agenda Item E-3 details Commissioner Michel Barnier’s reaction to the audit reforms and provides additional details on the reforms.
45. The EIOC noted that at the June 2012 IESBA meeting, the Board had considered the arguments for and against mandatory firm rotation or tendering on a “comply or explain basis” and had concluded there was insufficient evidence for the Board to establish a formal position on either approach. The Board had therefore agreed to closely monitor the developments in the EU and other parts of the world, but at the same time to review the long association provisions in the Code, particularly with respect to partner rotation, to ensure that they continue to be robust.
46. In addition to monitoring the developments within the EU, Board leadership has been actively reaching out to leadership within the EC to seek to raise awareness and recognition of the Code as a leading set of ethical standards for the global profession.
47. With respect to the EU agreement in the area of non-assurance services, IESBA staff has also committed to comparing the agreed provisions in the EU text against the relevant provisions in the Code to understand the nature and extent of differences.

**Matter for CAG Consideration**

5. Representatives are asked if the EU developments concerning audit reform warrant specific actions by the IESBA, other than those noted above. If so, what should these be?

*(ii) Other Developments*

48. The matters noted above are those that, after discussion, the EIOC believes warrant consideration by the Board.

**Matter for CAG Consideration**

6. Are there other developments internationally that Representatives believe the IESBA should

consider as part of its Emerging Issues initiative?

(iii) *Outreach*

49. Board leadership and other representatives have been active throughout 2013 in reaching out to stakeholders around the world. Country visits by the IESBA Chair in particular over the past 15 months or so have included Australia, China, France, Germany, Ireland, Italy, Japan, Myanmar, Portugal, South Africa, South Korea, Spain, the UK, the US and Vietnam. In addition to building closer liaison with the regulatory community, the Board has also been strengthening dialogue with the profession and other stakeholder groups.
50. The Board is committed to further enhancing its engagement with stakeholders, particularly CAG member organizations, all of which are key stakeholders for the Board. Already, Board leadership and other representatives have met with leadership and senior staff of a number of CAG member organizations throughout 2013 and in early 2014 to discuss matters of mutual interest. If there are further opportunities for dialogue with individual CAG member organizations, the Board would welcome hearing of them.

**Matter for CAG Consideration**

7. Representatives are asked to advise of any opportunities for closer engagement that the Board could explore with their individual organizations.

**Material Presented – CAG Reference Paper**

- Agenda Item E-1      Emerging Issues and Outreach Working Processes and Terms of Reference
- Agenda Item E-2      MG Rover Case – Background
- Agenda Item E-3      EU Audit Reform – Commissioner Barnier's Memorandum

## **Key References to “Public Interest” Included in the IESBA Code**

The IESBA Code includes the following key references to the concept of public interest:

1. Accepting responsibility to act in the public interest as a distinguishing mark of the accountancy profession:

A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Therefore, a professional accountant's responsibility is not exclusively to satisfy the needs of an individual client or employer. [Paragraph 100.1]

2. A requirement to comply with the Code to serve the public interest:

In acting in the public interest, a professional accountant shall observe and comply with this Code. If a professional accountant is prohibited from complying with certain parts of this Code by law or regulation, the professional accountant shall comply with all other parts of this Code. [Paragraph 100.1]

3. The conceptual framework approach assisting professional accountants in acting in the public interest:

The conceptual framework approach assists professional accountants in complying with the ethical requirements of this Code and meeting their responsibility to act in the public interest. [Paragraph 100.6]

4. When a professional accountant should consult a member body or regulator, if an outcome may not be in the public interest

When a professional accountant encounters unusual circumstances in which the application of a specific requirement of the Code would result in a disproportionate outcome or an outcome that may not be in the public interest, it is recommended that the professional accountant consult with a member body or the relevant regulator. [Paragraph 100.11]

## **Extracts from the ICAEW Code of Ethics**

### **Approach, Scope and Authority**

Professional accountants have a responsibility to take into consideration the public interest and to maintain the reputation of the accountancy profession. Personal self-interest must not prevail over those duties. This Code helps professional accountants to meet these obligations by providing them with ethical guidance.

### **General application of this code part A**

#### **100.1**

A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Acting in the public interest involves having regard to the legitimate interests of clients, government, financial institutions, employers, employees, investors, the business and financial community and others who rely upon the objectivity and integrity of the accounting profession to support the propriety and orderly functioning of commerce. This reliance imposes a public interest responsibility on the profession. Professional accountants shall take into consideration the public interest and reasonable and informed public perception in deciding whether to accept or continue with an engagement or appointment, bearing in mind that the level of the public interest will be greater in larger entities and entities which are in the public eye.

Therefore, a professional accountant's responsibility is not exclusively to satisfy the needs of an individual client or employer. In acting in the public interest, a professional accountant shall observe and comply with this Code. If a professional accountant is prohibited from complying with certain parts of this Code by law or regulation, the professional accountant shall comply with all other parts of this Code.

#### **100.6**

The circumstances in which professional accountants operate may create specific threats to compliance with the fundamental principles. It is impossible to define every situation that creates threats to compliance with the fundamental principles and specify the appropriate action. In addition, the nature of engagements and work assignments may differ and, consequently, different threats may be created, requiring the application of different safeguards. Therefore, this Code establishes a conceptual framework that requires a professional accountant to identify, evaluate, and address threats to compliance with the fundamental principles. The conceptual framework approach assists professional accountants in complying with the ethical requirements of this Code and meeting their responsibility to act in the public interest. It accommodates many variations in circumstances that create threats to compliance with the fundamental principles and can deter a professional accountant from concluding that a situation is permitted if it is not specifically prohibited.

#### **100.11**

When a professional accountant encounters unusual circumstances in which the application of a specific requirement of the Code would result in a disproportionate outcome or an outcome that may not be in the public interest, it is recommended that the professional accountant consult with ICAEW or the relevant regulator.

## Appendix 3

### Summary of FRC's Interpretation of "Considering the Public Interest"

In considering the allegations against Deloitte and Einollahi, the Executive Counsel to the FRC's Accountancy and Actuarial Discipline Board considered what could reasonably be expected of a member of the ICAEW (be it a firm or an individual) when considering the public interest.

The Counsel believed that it is not accurate that the only duty a member has is to act honestly and with integrity to a client. It was of the view that a member must meet this duty while also considering the effects of their actions on the public interest. It therefore argued that a member should take into consideration the public interest, and a reasonable and informed public perception, when deciding whether to accept or continue with an engagement, bearing in mind that the level of public interest will be greater in large enterprises and public interest entities.<sup>3</sup>

It also believed that this is not confined to audit work and that the public interest is still relevant in corporate finance work. It felt that if this were not the case, principles and statements in the ICAEW Code of Ethics would have specifically excluded corporate finance work or stated that consideration of the public interest is specific only to audit work. It believed that the provision concerning consideration of the public interest in the ICAEW Code is a "statement of general application" in any role that an accountant may take.

The Counsel took the view that the term public interest extends to the concern of clients, government, financial institutions, employers, employees, investors, the business and financial community and others who rely upon the objectivity and integrity of the accounting profession to support the propriety and orderly functioning of commerce.

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<sup>3</sup> MG Rover should have been considered a public interest entity by Deloitte and Einollahi as it was a sizeable manufacturer, it employed large numbers of people in the West Midlands, it sustained much of the local economy and members of parliament discussed its future when BMW chose to sell it to PVH. The fact the MG Rover was privately owned under PVH does not imply that the public interest can be ignored or discounted.