



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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Agenda Item

5

Board International Ethics Standards Board for Accountants

Meeting Location: Mandarin Oriental, Singapore

Meeting Date: November 2-3, 2010

Convergence

Objectives of Agenda Item

To continue the discussion of the IESBA's convergence initiatives and in particular:

- The form and content of the draft document identifying the independence requirements related to public interest entities;
- The use of the Code in a group audit situation; and
- The authority of the Code and the requirements contained in Statement of Membership Obligation 4.

Background

Convergence is identified as a priority in the IESBA's Strategy and Work Plan.

As noted in its proposed Strategy and Work Plan:

“In seeking to promote convergence of independence requirements, the IESBA recognizes that many regulators and other authorities are required to exercise their authority in relation to auditor independence. In addition, changes to existing national laws and regulations are often time consuming to effect. Accordingly, during the period of this strategic plan the IESBA will liaise closely with national standard setters and regulators to identify and understand their perspectives on convergence and to obtain their views on how the Code can be the catalyst to achieve greater convergence. In particular, the IESBA will be seeking input on:

- (a) Whether in a group audit situation, where the national independence standards in the jurisdiction of the parent auditor contain requirements that are more stringent than those contained in the Code, the parent auditor would accept foreign auditors of foreign subsidiaries complying with the independence requirements in Code; and
- (b) The types of improvements to the Code that standard setters and regulators believe should be made for the Code to gain acceptance and recognition in their jurisdictions.

The IESBA will consider input it has received from stakeholders, such as, for example, the need to more clearly identify the independence provisions in the Code related to public interest entities. Accordingly, it will prepare a document identifying those provisions to be used in discussions with national standard setters and regulators.”

Independence Requirements Relating to Public Interest Entities

At the June 2010 meeting in Paris, the IESBA discussed a first draft of a document that identifies the provisions in the IESBA Code that apply to the audits of Public Interest Entities. The document was supported by a more detailed document containing the complete text of Section 290 and providing the “audit trail” back to the Code. The IESBA discussed the draft document which was 30 pages long and provided comment on the document. This document has been revised based on the feedback received and is presented for reference purpose in Agenda Paper 5-B.

Some concern was expressed that the document was too detailed and a shorter document focusing on the prohibitions to demonstrate the strength of the Code would be useful. Another much shorter document (Agenda Paper 5-A) has been prepared. This document is higher level and focuses on the prohibitions.

Action Requested

IESBA members are asked to consider Agenda Paper 5-A and whether they believe it contains the appropriate level of detail to demonstrate the prohibitions and thus the robustness of the Code.

Code as Benchmark for Foreign Auditors of Foreign Subsidiaries

IFAC Statement of Membership Obligations provide that a member body of IFAC “should not apply less stringent standards than those stated” in the Code. Member bodies may, however, decide to maintain some existing requirements that are more restrictive than the Code. Similarly other national standard setters may have requirements that are more restrictive than the Code. In some cases these more restrictive requirements may apply not only to the auditors in that jurisdiction, but also to the foreign auditors of the foreign subsidiaries of those entities.

IESBA staff is aware of two jurisdictions, the APB in the UK and the AICPA in the US, which have explicitly addressed this matter. Appendix 1 to this paper contains the relevant extracts from the standards.

The APB standard requires the group auditor to be satisfied that the auditors (whether a network firm or another firm) involved in the audit of the group financial statements, who are not subject to APB Ethical Standards, are objective and document the rationale for that conclusion, and have complied with the Code.

The AICPA approach is to state that no enforcement action will be taken against a member who is a member of a *group engagement team* in cases where a foreign *component auditor* involved in the group audit is not in compliance AICPA Code provided the foreign *component auditor* at a minimum is in compliance with the IESBA Code.

The matter was discussed at the IESBA-NSS meeting held on October 18, 2010. At that meeting it was noted that promoting the use of the Code in group audit situations was a sensible first step to promote convergence - such an approach would facilitate individual jurisdictions maintaining more restrictive provisions which would apply domestically.

Many respondents to the Strategic Plan were supportive of the IESBA's stated convergence initiatives with several expressing support for using the Code in a group audit situation. One respondent, IOSCO, stated that many of its members believed that further improvements in the Code must precede such considerations.

The issue can be split into two separate questions: (a) whether there is support for the concept of using the Code in group audit situations and (b), if there is support, what improvements to the Code, if any, are necessary before a jurisdiction would accept use of the Code in group audit situations.

Action Requested

IESBA members are asked to consider the matter and whether they agree that IESBA should promote the matter and, if so, whether input to the two separate questions should be sought.

Code Authority and Statement of Membership Obligation 4

Member bodies of IFAC are subject to membership obligations and report, on a self-assessment basis, their compliance with the SMOs. The SMOs are developed by the Compliance Advisory Panel and issued by the IFAC Board. The Compliance Advisory Panel will shortly commence a project to review and revise the SMOs.

All of the SMOs contain the following text:

“In exceptional circumstances, a member body may depart from the obligations of this SMO, if doing so will fulfill its public interest duties more effectively. The member body should be prepared to justify the departure. A member body that fails to follow the obligations of this SMO, or justify satisfactorily why it has departed from them, may be suspended or removed from membership.”

SMO 4 addresses obligations with respect to the provisions of the Code of Ethics and states:

“Member bodies should not apply less stringent standards than those stated in the IFAC Code of Ethics. If a member body is prohibited from complying with certain parts of the Code by law or regulation, it should comply with the other parts of the Code.

Where responsibility for the development of national codes of ethics lies with third parties, member bodies should, in implementing their obligations of membership, have as a central objective the convergence of the national code with the IFAC Code. Member bodies should use their best endeavors to persuade those responsible for developing those national codes to incorporate the IFAC Code.”

The language “no less stringent standards” was developed by the IESBA (then the Ethics Committee) in 2001 when the revised independence requirements contained in Section 8 of the Code were issued. When the 2005 Code was issued, the “no less stringent” was moved to the preface of the Code. Neither the Code, nor the SMO provide any guidance on the meaning of “no less stringent”. There are at least two ways to interpret this matter:

- On a provision by provision basis – each requirement in the IESBA Code should be picked up by the member body and the provision should be no less stringent, but could be more stringent; or
- On an overall basis – the judgment is made on an overall basis weighing up the totality of the provisions in the Code and the totality of the provisions in the member body Code.

The matter was discussed with the IESBA-NSS at its meeting on October 18, 2010. The majority of IESBA-NSS members present expressed the view that the obligation should be viewed on an item by item basis. One member expressed the view that in his jurisdiction it had been considered on an overall basis.

Unlike SMO 3, which addresses the obligations with respect to documents issued by the IAASB, SMO4 does not include an obligation with respect to convergence where the responsibility for development of the national code lies with the member body. SMO4 paragraph 4 states:

“...member bodies should, in implementing their obligations of membership, have as a central objective the convergence of national standards or related other pronouncements with International Standards issued by the IAASB.”

Action Requested

IESBA members are asked to consider whether the meaning of “no less stringent standards” should be clarified, and if so, to state that the consideration should be made on a provision by provision basis.

IESBA members are asked to consider whether they are of the view that SMO4 should include convergence as a central objective.

Material Presented

Agenda Paper 5	This Agenda Paper
Agenda Paper 5-A	Provisions in the IESBA Code that apply to PIEs short document
Agenda Paper 5-B	Provisions in the IESBA Code that apply to PIEs longer document

Appendix A

Extract from APB Ethical Standard 1

Other Auditors Involved in the Audit of Group Financial Statements

- 51 The group audit engagement partner shall be satisfied that other auditors (whether a network firm or another firm) involved in the audit of the group financial statements, who are not subject to APB Ethical Standard, are objective and document the rationale for that conclusion.
- 52 The group audit engagement partner obtains appropriate evidence¹ that the other auditors have a sufficient understanding of and have complied with the current Code of Ethics for professional accountants including the independence requirements.²
- 53 In the case of a listed company, the group audit engagement partner establishes that the company has communicated its policy³ on the engagement of the external auditor to supply non-audit services to its affiliates and obtains confirmation that the other auditors will comply with this policy.

Network Firms Not Involved in the Audit

- 54 The audit firm shall establish that network firms which are not involved in the audit are required to comply with global policies and procedures that are designed to meet the requirements of the current IFAC Code.
- 55 The IFAC Code requires all network firms to be independent of the entities audited by other network firms. International audit network commonly meet this requirement through global independence policies and procedures designed to comply with the current IFAC Code which are supported by appropriate monitoring and compliance processes within the network.

¹ ISA (UK and Ireland) 600 *Using the Work of Another Auditor* states that “The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor’s purpose, in the context of the specific assignment.”

² The International Federation of Accountants (IFAC) Code of Ethics for Professional Accountants (the IFAC Code) establishes a conceptual framework for applying the fundamental principles of professional ethics for professional accountants. Section 290 of the IFAC Code illustrates the application of the conceptual framework to independence requirements for audit engagements and represents the international standard on which national standard should be based. No Member Body of IFAC is allowed to apply less stringent standards than those stated in that section. In addition, members of the IFAC Forum of Firms have agreed to apply ethical standards, which are at least as rigorous as those of the IFAC Code.

³ The Combined Code on Corporate Governance requires audit committees to develop the company’s policy on the engagement of the external auditor to supply non-audit services.

**AICPA Professional Ethics Executive Committee
Non-Enforcement Policy**

The Professional Ethics Executive Committee (PEEC) has agreed that it will not take enforcement action against a member who is a member of a *group engagement team* in cases where a foreign *component auditor* involved in the group audit is not in compliance with the AICPA Code of Professional Conduct (AICPA Code) provided the foreign *component auditor* at a minimum is in compliance with the IESBA Code of Professional Ethics for Accountants (IESBA Code) and the members of the *group engagement team* are in compliance with the AICPA Code of Professional Conduct. (See SAS on *Special Considerations— Audits of Group Financial Statements (Including the Work of Component Auditors)*).

Furthermore, the PEEC will not take enforcement action against a member who is a member of a *network firm* in cases where another firm within that *network* that is located outside the United States (“foreign network firm”) is not in compliance with the AICPA Code provided the foreign network firm at a minimum is in compliance with the IESBA Code. (See ET section 92.28-.29 for definitions of network and network firm).

Adopted by the PEEC on August 20, 2010.

Appendix B

STATEMENT OF MEMBERSHIP OBLIGATIONS 4
IFAC CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS
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This Statement of Membership Obligations (SMOs) is issued by the IFAC Board. It is to be applied by member bodies of IFAC to ethics standards for professional accountants. It applies whether the member bodies issue such standards, or whether the standards are issued by another body.

Where government, regulators or other appointed authorities perform any of the functions covered by this SMO, member bodies should (a) use their best endeavors to encourage those responsible for those functions to follow this SMO in implementing them, and (b) assist them in that implementation where appropriate.

This SMO sets out the obligations of member bodies in relation to the IFAC Code of Ethics for Professional Accountants (the IFAC Code of Ethics) and other pronouncements issued by the International Ethics Standards Board for Accountants (IESBA) of IFAC. To understand and apply the obligations (identified in bold type), it is necessary to consider the whole text of the SMO, including the explanatory and other material contained in the SMO.

Associates are also required to complete self-assessments of compliance with SMOs to demonstrate their continuing progress toward membership. In applying this Statement to associates, IFAC will recognize the stage of development, availability of resource, and scope of activities of each associate and its members.

This SMO does not apply to affiliates. Consistent with the obligations relating to affiliates in the IFAC Bylaw, however, affiliates are expected to support the development and implementation of the Code and other pronouncements of the IESBA.

Despite the general application of SMOs to member bodies and the self-assessments also required of associates, IFAC will take into account the relevance of individual SMO obligations to each member body and associate in assessing its level of compliance. This recognizes the fact that some member bodies and associates and their members operate in different sectors of the profession and some SMOs may not apply to them in their entirety.

In exceptional circumstances, a member body may depart from the obligations of this SMO, if doing so will fulfill its public interest duties more effectively. The member body should be prepared to justify the departure. A member body that fails to follow the obligations of this SMO, or justify satisfactorily why it has departed from them, may be suspended or removed from membership.

Obligations

1. **Member bodies should notify their members of the provisions of the IFAC Code of Ethics and other pronouncements developed by IESBA.**
2. IESBA exposes proposed revisions to the IFAC Code of Ethics for public comment. Member bodies are encouraged to notify their members of all exposure drafts issued by the IESBA and to encourage them to comment on behalf of those members that have an interest in ethics for professional accountants.
3. The IFAC Code of Ethics establishes the fundamental principles of professional ethics for professional accountants and provides a conceptual framework and guidance for applying those principles.
4. **Member bodies should not apply less stringent standards than those stated in the IFAC Code of Ethics. If a member body is prohibited from complying with certain parts of the Code by law or regulation, it should comply with all other parts of the Code.**
5. **Where responsibility for the development of national codes of ethics lies with third parties, member bodies should, in implementing their obligations of membership, have as a central objective the convergence of the national code with the IFAC Code of Ethics. Member bodies should use their best endeavors to persuade those responsible for developing those national codes to incorporate the IFAC Code of Ethics**

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Interpretation

6. A member body has used its “best endeavors” if it could not reasonably do more than it has done and is doing to meet the particular membership obligation.
7. Member bodies are encouraged to make counseling and advice available to their members to help resolve ethical conflicts. Doing so plays an important part in implementing ethical requirements. For example, member bodies can (a) provide a service that responds to questions raised by individual members on interpretations of ethical requirements, or (b) form appropriate committees within member bodies who monitor their ethical requirements.
8. An interpretation/advice/counseling service will ordinarily include the following features:
 - Its purpose and operating procedures are clear, understandable and widely promoted to the members.
 - Its operating procedures provide safeguards to (a) avoid having to consider unreasonable questions from members, and (b) make the questioner responsible for clearly setting out the facts and circumstances.

- Those who are responsible for providing the advice hold positions at a level commensurate with such authority and have sufficient technical expertise and practical experience to provide such advice.
 - Inquiries are ordinarily made on a confidential basis.
 - Results of any interpretation/counseling/advice questions that are of broad interest are subject to publication (on a “no-name” basis) for the members as an educational method.
9. Introducing a communication program designed to make individual members aware of all ethical requirements, and the consequences of non-compliance, may assist member bodies to implement ethical requirements. Information may be communicated in such ways as:
- Members’ handbooks.
 - Technical releases.
 - Professional journals.
 - Reports on disciplinary hearings and activities.
 - Programs of continuing professional development.
 - Newsletters.
 - Financial and business press.
 - Responses from the appropriate committee to requests for advice.

Effective Date

10. This SMO is effective as of December 31, 2004 and was last amended as of November 10, 2006.