

# **Annual review of APES 110 Code of Ethics for Professional Accountants issued in June 2006**

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## **1. Executive Summary**

### **1.1. Background**

Accounting Professional and Ethical Standards Board (APESB) issued APES 110 *Code of Ethics for Professional Accountants* (the Code) in June 2006 with an effective date of 01 July 2006.

### **1.2. Reason for this report**

In accordance with the constitution of APESB, a review needs to be performed annually after an issue of a new standard. This report presents a review of the issues identified and a proposed course of action to address them.

### **1.3. Issues identified**

The concerns identified by stakeholders since issue of the standard are summarised below.

#### *Issues arising subsequent to the 6 Month Review:*

- 1 Impact of international exposure draft of Sections 290/291 Independence part II.
- 2 Definition of an assurance engagement.
- 3 Definition of an audit engagement.
- 4 Drafting of paragraph 200.3 of the Code – discussion of threats and safeguards.
- 5 Definition of a firm.
- 6 Corporations Act Legislation Amendments and its impact on Section 290 Independence of the Code.

#### *Carry Forward Issues from 6 Month Review:*

- 7 Use of footnoting of the Code to identify the corresponding reference/section in the *Corporations Act*.
- 8 Use of terminology “Financial Statement Audit Client”.
- 9 Use of terminology “Financial Statement” rather than “Financial Report”.
- 10 The International Ethics Standards Board for Accountants (IESBA) has issued an exposure draft of Section 290 (and proposed new Section 291) of the Code which now incorporates a definition of a network firm.
- 11 Lack of statement of conformity with the applicable International Standard.
- 12 Use of terminology “Professional Services” rather than “Public Accountancy Services”.
- 13 Formatting error of heading in paragraph 290.170 of the Code.
- 14 Issues included in the previous Joint Code of Professional Conduct.

#### **1.4. Summary of Recommendations**

The following is a list of the recommendations contained in the main report. It is recommended that:

##### *Issues arising subsequent to the 6 Month Review:*

1. APESB to monitor changes to Section 290/291 Independence Part II at the international level. It is expected that IESBA will finalise the amendments in April 2008 at which time APESB will review conclusions reached and consider the need to update the Code to achieve consistency with the revised IFAC Code.
2. The definition of an assurance engagement to be updated in the next revision of the Code in line with the AUASB' changes to Framework for Assurance Engagements.
3. The definition of an audit engagement to be updated in the next revision of the Code to incorporate reasonable assurance.
4. Wording of section 200.3 to be amended in the next revision of the Code to improve clarity.
5. The definition of Firm to be updated in the next revision of the Code to ensure consistency with other APES Standards.
6. The professional bodies in consultation with the RDGIT to submit a proposal for the consideration of the Board on the impact of the Corporations Act Legislation amendments on the Code. The Board to consider this submission at its 20<sup>th</sup> November Board meeting.

##### *Carry Forward Issues from 6 Month Review:*

7. Issues raised in respect of cross referencing the Code to the Corporations Act, either by members, firms, or regulatory bodies be monitored and assessed for implications that will require a change to the Code. No changes currently recommended.
8. Continue to monitor the issue in respect of "Financial Statement Audit Client" with the intent to update the terminology following final revision of Section 290 and 291 of the IFAC Code.
9. The term Financial Report is defined in the AUASB glossary and is broadly consistent with the definition of financial statements in the Code. APESB will monitor the issue and consider updating the definition in line with the new International Code due to be issued in April 2008.

10. The Board to consider comments received on the “network firm” definition at its 20<sup>th</sup> November Board meeting. This issue will be resolved once the Board approves the final version of the network firm definition.
11. In the next revision of APES 110 include a Statement of conformity with the IFAC Code of Ethics for Professional Accountants.
12. APESB will monitor developments in this respect via the issues register to assess whether any action is required to align the definition of Professional Services in the Code with the definitions of the professional bodies.
13. Amend the formatting error in the header of S.290 in the next revision of the Code.
14. The left over issues from the previous code will be monitored by APESB in consultation with the professional bodies to assess the need to introduce any additional guidance. In respect of F2: *Prospectus and Reports on Profit Forecasts*, APESB considered a project proposal at its August 2007 Board meeting and has decided to establish a taskforce to develop a pronouncement to replace F2.

## **2. Review of Implementation Issues**

### **Issues arising subsequent to 6 month review**

#### **2.1 Impact of IESBA revision of Sections 290/291 Independence Part II**

##### **Issue**

IESBA is currently revising Section 290/291 Independence and had invited feedback on the above mentioned exposure draft by 15<sup>th</sup> October 2007.

##### **Analysis of issue**

As part of its revision of Section 290/291 of the Code, IESBA are considering three areas on which they have invited comments in this exposure draft. These areas are internal audit, fees- relative size and contingent fees. APESB considered the exposure draft and prepared a submission which was submitted to the IESBA by the due date.

##### **Stakeholders**

IESBA

##### **Recommendation**

It is recommended that APESB continue to monitor this issue with the intent to resolve it following finalisation of Section 290/ 291 Independence at the international level. It is expected that this will occur in April 2008 at which time APESB will review conclusions reached and consider the need to update the Code to achieve consistency with the revised IFAC Code.

#### **2.2 Definition of an Assurance Engagement**

##### **Issue**

The definition of an assurance engagement in the Code refers to AUS108 which has been replaced by the Framework for Assurance Engagements by the AUASB in July 2007.

### **Analysis of issue**

The definition of assurance engagement is no longer accurate following the replacement of AUS108 in July 2007.

The revised definition of Assurance Engagement should incorporate the following: “This would include an Engagement in accordance with *Framework for Assurance Engagements* issued by the Auditing and Assurance Standards Board (AUASB) or in accordance with the specific relevant standards for Assurance Engagements.”

### **Stakeholders**

Professional Accountants, Auditors

### **Recommendation**

The definition needs to be updated in the next revision of the Code.

## **2.3 Definition of an Audit Engagement**

### **Issue**

The definition of audit engagement in the Code refers to a high level of assurance whilst the AUASB standards include a reasonable level of assurance.

### **Analysis of issue**

The definition of Audit Engagement in the Code reads as follows: “*An Assurance Engagement to provide a high level of assurance that a financial report is free of material misstatement, such as an Engagement in accordance with Australian Auditing Standards.*” The provision of a “high level” of assurance reflects outdated terminology with current Australian auditing standards describing audit engagements as providing a reasonable level of assurance.

### **Stakeholders**

Professional Accountants, Auditors

### **Recommendation**

The definition of an Audit engagement needs to be amended in the next revision of the Code.

## 2.4 Drafting of paragraph 200.3 of the Code – discussion of threats and safeguards

### Issue

On review of section 200.3 of the Code, the ICAA has suggested a minor drafting revision to enhance clarity of the paragraph.

### Analysis of issue

The Code currently reads as follows: “*The nature and significance of the threats may differ depending on whether they arise in relation to the provision of services to a Financial Statement Audit Client, a non-financial statement audit Assurance Client or a non-Assurance Client.*”

The ICAA have proposed the following amendment: “*The nature and significance of the threats may differ depending on whether they arise in relation to the provision of services to a Financial Statement Audit Client, an Assurance Client that is not a non-Financial Statement Audit Assurance Client, or a non-Assurance Client.*”

### Stakeholders

APESB, Professional Bodies, Members

### Recommendation

We agree that the revised wording improves the clarity and will consider this issue in the next revision of the Code.

## 2.5 Definition of Firm

### Issue

The definition of “Firm” in the Code is not consistent with recent exposure drafts and standards.

### Analysis of issue

Recent exposure drafts and APES 320 Quality Control for Firms define firm using the following: “*A sole practitioner, partnership, corporation or other entity of professional accountants*”. The additional words “or other entity” are not currently incorporated in the Code. Use of the words “other entity” will result in entities such as trusts being captured by the definition.

In addition, part (c) and part (d) of the components to the definition of a firm is connected by the word “and”. This implies that all four components of the definition must be met to satisfy the definition. It is unlikely that any firm would therefore meet this definition.

As recommended by one of the respondents to an ED, the “and” needs to be replaced with an “or”.

### **Stakeholders**

Professional Accountants and professional bodies.

### **Recommendation**

It is recommended that the insertion of the additional wording “other entity” and the change from “and” to “or” be incorporated in the next revision of the Code to improve the clarity and as well as consistency with the other APES Standards.

## **2.6 Corporations Law Legislation Amendments**

### **Issue**

Introduction of The Corporations Legislation amendments on 1 July 2007 and its impact on current Section 290 of the Code.

### **Analysis of issue**

The Corporations Legislation amendment (Simpler Regulatory System) is now effective resulting in some changes to the auditor independence requirements. One of the main changes is the removal of the restriction on all partners in a firm from holding a financial interest in an audit client to only those persons who are professional members of the audit team or can influence the outcome of the engagement. This will in effect mean reverting to the financial interest rules contained in the IESBA Code and F.1 prior to CLERP 9.

### **Stakeholders**

Professional Accountants, Auditing Firms

### **Recommendation**

This issue was discussed with the professional bodies and several big four firms who are represented on the Institute’s Regulatory Discussion Group Independence Taskforce (RDGIT). It was agreed that the professional bodies in consultation with the RDGIT will make a submission for the consideration of the Board to APESB’s 20<sup>th</sup> November Board meeting.

## **Carry forward issues from 6 month review**

### **2.7 Draft footnoting of the Code to identify the corresponding reference/section in the Corporations Act.**

#### **Issue**

At the time of issuing the standard APESB considered the need to footnote the Code to identify the corresponding reference/section to the *Corporations Act*. However, it was expected that stakeholders will comment on this issue and the Board decided to revisit this issue at a later date.

#### **Analysis of the issue**

As the Code currently stands, no cross references have been provided against the *Corporations Act*. ASIC has raised a few concerns in respect of consistency of terminology between the Code and the *Corporations Act*. However, the examples given to date are not significant. Previously the RDG Independence Task Force of the ICAA also had noted this as a potential issue.

During the post implementation period, members have not raised any concerns or requested a mechanism to cross reference the Code with the *Corporations Act*.

#### **Impacted Stakeholders**

Professional Accountants, Auditors, Regulatory Bodies

#### **Recommendation**

It is recommended that any issues that are raised in this context by members, firms or regulatory bodies be monitored and assessed on an ongoing basis. No changes to the Code are currently recommended.

### **2.8 Use of terminology “Financial Statement Audit Client”**

#### **Issue**

The Board has been advised that the International Ethics Standards Board for Accountants (IESBA) is considering a change in the use of this terminology, and resolved to monitor this issue with a view to reconsidering it in the future, for possible adoption in APES 110.

### *Analysis of the issue*

In the redraft of Section 290 and 291, the IESBA has removed the definition of the term “Financial Statement Audit Client” and has included a definition of “Audit Client”. Thus the IESBA appear to have redrafted the Code in such a way that there is no longer the need to distinguish between a “Financial Statement Audit Client” and another form of “Audit Client”.

### *Stakeholders*

Auditors, Professional Accountants

### *Recommendation*

It is recommended that APESB continue to monitor this issue with the intent to resolving it following finalisation of Section 290 and 291 at the international level. It is expected that the new IFAC Code will be issued in April 2008. APESB will refer the review of the IFAC Code to its Code of Ethics task force for consideration.

## **2.9 Use of terminology “Financial Statement” rather than “Financial Report”**

### *Issue*

The Board had previously resolved to use the terminology “financial statement” because it was a term defined in the IESBA Code, rather than the term used in the Australian auditing standards, “financial report”, which was undefined. This issue was raised as part of the six monthly review of the Code for the Board to consider at a future time.

### *Analysis of the issue*

The Code defines “Financial Statement” as follows:

*“The balance sheets, income statements or profit and loss accounts, statements of changes in financial position (which may be presented in a variety of ways, for example, as a statement of cash flows or a statement of fund flows), notes and other statements and explanatory material which are identified as being part of the financial statements”*

The AUASB Glossary does have a definition and it defines “Financial Report” as follows:

*“ Means a structured representation of the financial information, which ordinarily includes accompanying notes, derived from accounting records and intended to communicate an entity’s economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial framework. The term may refer to a complete financial report, but in some jurisdictions, it may also refer to a single financial statement, for example, a balance sheet, or a statement of revenues and expenses, and related explanatory notes. The requirements of the financial reporting framework determine the form and the content of the financial report and what constitutes a complete financial report. A financial report, as defined under sections 295 and 303 of the Corporations Act 2001 and Accounting Standard AASB 101 Presentation of Financial statements, consists of financial statements for the year and half year respectively, notes to the financial statements and the director’s declaration about the statements and the notes”.*

The AUASB definition is broader and incorporates the requirements of the *Corporations Act* as well. However, on an overall basis the definitions are not inconsistent with each other. The IESBA exposure draft on S.290 and S.291 also incorporates a definition of financial statements which is closer to the AUASB glossary excluding the reference to the *Corporations Act 2001*.

### **Stakeholders**

Auditors, Professional Accountants

### **Recommendation**

The term “Financial Report” has been defined in the AUASB Glossary and the definition is consistent with the definition of “Financial Statement” in the proposed new Code. APESB will monitor this issue and consider updating the definition in line with the new International Code which is due to be issued in April 2008.

**2.10 The International Ethics Standards Board for Accountants (IESBA) has re-issued Section 290 of the Code which now incorporates a definition of a network firm.**

**Issue**

Section 290 of the *Code of Ethics for Professional Accountants* was revised by the IESBA in July 2006. The main change is the inclusion of paragraphs S. 290.14 to S. 290.26 which define and explain what would be considered to be networks and network firms. In line with this, the definitions of network and network firms have also been amended. The effective date of the revised standard is for reports dated on or after December 31, 2008.

**Analysis of issue**

In respect of assurance engagements, it is imperative that the firm performing the assurance role and when applicable network firms, be independent of the assurance client. A network is defined as a larger structure that is **aimed at co-operation and has one or more** of the following elements:

- Profit or cost sharing
- Shares common ownership
- Shares control or management
- Common quality control policies and procedures
- Common business strategy
- Use of common brand name
- Use of a significant part of professional resources

Professional accounting firms who perform assurance engagements and that have business/operating agreements or referral networks with other firms will need to evaluate the requirements of this standard and evaluate whether they will be deemed to be in a network. If the answer is affirmative then prior to accepting an assurance engagement the firm will need to ensure that the network of firms is independent of the prospective assurance client.

**Stakeholders**

Professional Accounting firms who are operating in a network or who may be deemed to be operating in a network under the guidelines issued by the new standard.

### **Recommendation**

APESB developed an exposure draft detailing amendments to section 290 of the Code in May 2007 to achieve international consistency with the IESBA definition of network firms. Comments received on the exposure draft are to be tabled at the 20<sup>th</sup> November 2007 board meeting. The Board will consider the issues raised by constituents on the exposure draft and finalise the standard. As APESB is in the process of finalising a standard on the Network firms definition this issue will be resolved once the Board approves the final version of the network firm definition.

## **2.11 Statement of conformity with the applicable International Standard**

### **Issue**

APES 110 does not currently have a statement of conformity with its international equivalent issued by the IESBA.

### **Analysis of issue**

As a matter of best practice APES 110 should have a conformity paragraph to inform the users and stakeholders of the extent of its compliance with the IFAC Code.

### **Stakeholders**

Professional Accountants.

### **Recommendation**

It is recommended that the next revision of the standard incorporate a paragraph which compares APES 110 with the *Code of Ethics for Professional Accountants* issued by the IESBA.

## **2.12 Use of terminology “Professional Services” rather than “Public Accountancy Services”**

### **Issue**

The Code has a definition of “professional services” which is from the IFAC code. The ICAA defines a concept of “Public Accountancy Services”. There are subtle differences and the ICAA has proposed that the Code’s definition can be expanded by the addition of words such as “and other services as identified by a professional body that adopted this code as applicable to its members”.

### **Analysis of issue**

Professional services are defined in the Code in the following manner:

*Services requiring accountancy or related skills performed by a professional accountant including accounting, auditing, taxation, management consulting and financial management services*

ICAA defines Public Accountancy Services as follows:

*Means accounting, auditing, management consulting, taxation, financial management and insolvency services as the Board may from time to time determine to be “public accountancy services”*

Each of the professional bodies will have a definition that will be broadly similar to the definition included in the IFAC code. At the time APES 110 was introduced (June 2006) there was the expectation that the different definitions could cause problems in practice. However, to date the different definitions have not caused significant problems in practice.

### **Stakeholders**

APESB, Members of the Professional Accounting Bodies

### **Recommendation**

APESB will monitor developments in this respect via the issues register to assess whether any action is required to align the definition of Professional Services with the definitions of the professional bodies.

## **2.13 Formatting error of heading in paragraph 290.170 of the Code**

### **Issue**

The heading of paragraph 290.170 is in bold when it should be in italics.

### **Analysis of issue**

No analysis required as it is a formatting error.

### Stakeholders

APESB

### Recommendation

To be amended in the next revision of the Code.

## 2.14 Other Matters

Detailed below are other matters that need to be addressed. These issues do not directly impact on APES 110, however, for completeness is presented in this review.

<b>Issue</b>	<b>Proposed resolution</b>
Issues included in the previous Joint Code of Professional Conduct such as advertising and practice names now not in the current Code of Ethics for Professional Accountants they may require further guidance	These matters were addressed in the previous code and the professional bodies intend on addressing these issues however, it has been assigned a low priority. APESB will monitor the need for additional guidance in this area in consultation with the professional bodies.
Professional Statement F2 : <i>Prospectus and reports on Profit Forecasts</i>	A project proposal was considered by the Board for the development of a Standard at the August 2007 Board meeting. A taskforce will be assembled for the development of this standard.