

AGENDA PAPER

Item Number: 11.10
Date of Meeting: 17 November 2009
Subject: APES 110 *Code of Ethics for Professional Accountants*

Action Required **For Information Only**

Purpose

To provide an update to the Board on the progress of the Code of Ethics project, to provide an update on key issues identified to date for the consideration of the Board and to seek direction from the Board.

Background

At the May 2009 meeting, the Board approved a project to update APES 110 *Code of Ethics for Professional Accountants* to bring the requirements of APES 110 into alignment with the IFAC *Code of Ethics for Professional Accountants* (IFAC Code) that was reissued in July 2009 by the IESBA.

Project Status

29 June 2009	Task Force Meeting – planning and allocation of tasks agreed with taskforce members (refer attached minutes).
June 2009	APESB technical staff prepared a comparative table of the requirements of the new IFAC Code against the existing APES 110 on a paragraph-by-paragraph basis.
3 July 2009	The comparative tables were separated and distributed to relevant task force members who were allocated components of the Code.
August - Oct 2009	Technical staff general review of IFAC Code including consideration of drafting conventions.
14 September 2009	Task Force Meeting – discussion relating to review of Parts A, B (excluding sections 290 and 291) and C of the Code (refer attached minutes).
9 October 2009	Task Force Meeting – discussion relating to definitions and review of Part B of the Code (sections 290 and 291) (refer attached draft minutes).
October 2009	Task Force review comments added to comparative table.
October 2009	Technical staff analysis of structure of sections 290 and 291.

Consideration of Issues

The APES 110 Code of Ethics project is progressing and a few issues have been identified by the taskforce and APESB technical staff for the consideration of the Board. These issues have been categorised into major or minor issues.

Major Issues

1. Drafting Conventions

Format of mandatory/guidance paragraphs

APESB technical staff has observed that the IFAC Code contains a mixture on mandatory requirements and guidance in the same paragraph. It is proposed that such paragraphs are split so that mandatory requirements are separated from guidance consistent with APESB drafting conventions.

Defined terms

APESB technical staff notes that the IFAC Code and APES 110 contain different and additional defined terms. This matter was discussed at the Task Force meeting on 9 October where two views were expressed. One view was that APES 110 should adopt IFAC terms without amendment. Another view was that defined terms should be amended and modified to suit the Australian environment where necessary.

When the Board last considered APES 110, some terms were modified or added to APES 110 to suit the Australian environment including: assurance engagement; audit client; audit engagement; audit team; clients; engagement; firm; managerial employee; member; member in public practice; officer; partner; These terms have also been used in other standards issued by the Board.

Technical staff proposes to retain existing Australian terminology and to consider any necessary modifications to new terms introduced by the revised IFAC Code that may be required to facilitate effective application of the principles of the IFAC Code in the Australian context. We will also review the revised AUASB glossary which has just been issued (October 2009) for the clarity version of auditing standards where similar terms may be defined.

A substantive issue is the new definition of “public interest entity” in the revised IFAC Code which is discussed below.

2. Definition of public interest entity

The IFAC Code defines a public interest entity as:

- “(a) A Listed Entity; and
- (b) An entity (a) defined by regulation or legislation as a Public Interest Entity or (b) for which the audit is required by regulation or legislation to be conducted in compliance with the same Independence requirements that apply to the audit of listed entities. Such regulation may be promulgated by any relevant regulator, including an audit regulator.”

Paragraph 290.26 encourages firms and member bodies to consider whether ‘other entities’ should also be treated as public entities. The definition of public interest entity is central to the “stricter” independence requirements of section 290 of the revised IFAC Code.

The Code of Ethics Taskforce discussed the definition of public interest entity at its meeting on 9 October 2009. Taskforce members acknowledged that the first part of the definition, which addresses listed entities, was uncontroversial and that their concerns were in relation to applying the second part of the definition concerning other entities that may be regarded as public interest entities. The taskforce expressed differing views as to the types of entities that should be regarded as public interest entities. One view was that the obligation for deciding when an entity was regarded as a public interest entity should be left for Members to determine and this would avoid the need to make changes to the IFAC Code. Another view was that the definition required careful consideration and potential re-defining and/or guidance to ensure it could be consistently

applied in the Australian context. Taskforce members also noted that this could be a specific question that could be raised at the exposure draft stage.

APESB technical staff subsequently met with Australian Accounting Standards Board (AASB) staff to ascertain the current status of the AASB's differential reporting project which was dealing with a similar issue. The AASB Technical Staff view was that the scope of the AASB's definition was likely to be narrower in its application than what could be used in a revised APESB Code of Ethics. The AASB viewed its role as defining and clarifying the concept of general purposes financial reports (GPFRs) and promulgating different tiers/choices of reporting requirements for use by entities in preparing GPFRs. AASB Technical staff acknowledged that the APESB definition is likely to be broader as their primary focus would be "for profit entities" whilst the Code's definition should be broader to suit all entities where members of the accounting profession perform professional services. APESB technical staff will continue to monitor the AASB's position which is not expected to be finalised until mid-late 2010.

APESB technical staff view is that an attempt should be made to define this term in the Australian context at the exposure draft stage and to seek public comment on the issue.

3. 2006 APESB decisions

In 2006 when APESB initially issued APES 110 in Australia, the APES Board made changes to the IFAC Code to tailor it to the Australian environment. This modified version of the IFAC Code has been used in Australia over the last 4 years.

We propose to highlight the 2006 Board decisions in the comparative table.

4. Consideration of the new Code in the Australian context

Taskforce members have expressed two different views in respect of considering the new IFAC Code. Some taskforce members were of the view that no changes should be made to the IESBA wording and/or requirements as it has gone through a global consultation process. A further point that has been made is that IESBA is considering convergence and if minimal changes are made then that will assist with the IESBA convergence process. Other taskforce members are of the view that the Code needs to be evaluated in the Australian context and changes should be made where necessary to suit the local environment.

APESB technical Staff are also of the view that the revised Code needs to be evaluated in the Australian context.

APESB was one of the National Standard Setters present at the inaugural IESBA National Standard Setters (NSS) meeting in April 2009 and it was clear that there are quite different legal and regulatory frameworks operating in different countries. As per the IESBA draft minutes, IESBA Chair Richard George notes when reporting on the NSS meeting:

"...that few of the jurisdictions represented at the NSS have implemented the Code verbatim and several have added Code-plus requirements. Mr. George noted that it was apparent from the discussions that differences in legislative and regulatory structures present one of the more significant challenges to convergence."

In considering the issue of convergence, the IESBA has stated that:

“Convergence is the process of moving towards the same point.”

IESBA notes that the term convergence means different things to different people in comparing national and global standards, including:

- Standards are fully converged and identical;
- Standards are “harmonized”; (e.g. both use the same approach but the language is different); and
- Standards achieve the same result – “equivalence” (somewhat less than harmonisation but have broadly similar effects).

Convergence has been on the agenda at the October 2009 IESBA Board meeting. The Board paper notes that whilst there has been progress on international convergence on accounting and auditing standards that the convergence of international and national ethics standards is less advanced. IESBA notes that:

“Member bodies of IFAC are required by under the Statement of Membership Obligations (“SMOs”) to apply no less rigorous standards than those stated in the Code unless prohibited by law or regulation from complying with certain parts of the Code, in which case it should comply with all other parts of the Code. Member bodies of IFAC completed a self-assessment of compliance with the SMOs. With respect to those member bodies that establish ethical requirements (as opposed to those jurisdictions where ethical requirements are established by law or an external body), 30% of member bodies indicated they were using the 2006 version of the Code, 35% indicated use of the 2004 Code (which includes the updated independence requirements included in Section 8) and 35% indicated use of an earlier version of the Code.”

In the case of APES 110 it will fall into the top 30% as it is the 2006 version of the Code and it is an IFAC-plus version of the Code (as it has requirements that are more stringent than the IFAC Code).

In the context of convergence, the IESBA Board papers notes that:

*“In seeking to promote convergence of independence requirements, IESBA is mindful that existing national requirements of law and regulation are usually time consuming and difficult to change and in particular require public justification, bearing in mind that the laws and regulations were put in place in that jurisdictions to protect the public interest. Many securities regulators and other authorities are mandated to exercise their authority in relation to auditor independence. **It is unlikely to be easily possible therefore in the short or medium term for their codes, regulations or rules either to replicate exactly the Code or to commit in advance to adopting any future changes to the Code.**” [Bolding of the text added]*

Therefore convergence of the Code at a global level is going to be a challenging process which is unlikely to occur in the short or medium term. The existing APES 110 is in most respects identical to the IFAC Code and in other respects has adopted higher requirements than the IFAC Code.

Accordingly, APESB technical staff view is that a primary consideration from APESB’s perspective is to perform a proper evaluation of the revised IFAC Code in the Australian context. Convergence is a secondary issue and APESB can monitor the IESBA’s progress on this project.

5. Application of Requirements and Repetition – Sections 290 and 291

Application of Requirements

The introductory paragraphs of sections 290 and 291 explain the intended structure and application of each section. Section 290 of the IFAC Code has been designed to address independence requirements for audit engagements and review engagements, which are assurance engagements in which a member in public practice expresses a conclusion on financial statements. Section 291 addresses independence requirements for assurance engagements that are not audit engagements or review engagements. Given that audit and review engagements are a form of assurance engagement, section 291 is best described as being applicable to other assurance engagements, that is engagements that are other than audit or review engagements.

Aside from the introductory paragraphs, the principles to be applied in section 290 refer mainly to audit engagements whilst section 291 refers to assurance engagements. However, without reading the introductory paragraphs to section 290/291, it is not immediately evident that the requirements relate to only particular types of engagements. For example, after the first few paragraphs section 290, the remainder of the paragraphs mainly refer to audit engagements when the requirements equally apply to review engagements. In the case of 291 it refers to assurance engagements which may be construed to include audit and review engagements. Thus the demarcation of the different types of engagements is not clear unless you read the first few paragraphs of section 290/291.

In the Australian environment clarity is critical as the AUASB is going to introduce ASA 102 which refers to relevant ethical requirements. The definition of relevant ethical requirements refers to APES 110 and thus the application to audit, review and other assurance engagements needs to be clearly specified. From a clarity perspective, it would be beneficial to structure sections 290 and 291 in a manner that the engagements that they apply to are clear for members, firms, regulators (such as ASIC) and clients.

Repetition

A significant degree of repetition is evident when comparing the requirements of sections 290 and 291 of the IFAC Code. While the underlying conceptual framework approach to independence is adopted in a consistent manner in both sections, it seems unnecessary to duplicate the same common requirements in both sections. APESB technical staff have identified that approximately 70 paragraphs (i.e. 74% of section 291), has been replicated from section 290.

APESB technical staff believes that the removal of repetitious sections would add clarity and remove unnecessary bulk from the Code. APESB technical staff propose that alternative ways to present the requirements of section 290 and 291 needs to be explored.

Minor Issue

1. Preparation and Reporting of Information

Section 320 of the IFAC Code requires a Member in Business who has responsibility to prepare or approve general purpose financial statements to be satisfied that those financial statements are prepared in accordance with an applicable financial reporting framework.

The issue that arises from these requirements relates to a Member in Business who is acting as a preparer of general purpose financial statements. There may be circumstances where a Member in Business who is a preparer has a different opinion to the Board of Directors who have ultimate authority to approve the general purpose financial statements. The Member in Business may be directed to present information in a way that conflicts with their judgement about what is “true and fair” in accordance with an applicable financial reporting framework. In such circumstances the obligation to comply with the Code should be specified in a manner that the Member in Business

takes reasonable steps rather than imposing a mandatory obligation to ensure compliance with an applicable financial reporting framework.

Staff Recommendations

- Mandatory requirements should be separated from guidance or explanatory paragraphs consistent with APESB drafting conventions;
- Defined terms continue to be capitalised in accordance with APESB drafting conventions;
- A definition of Public Interest Entity tailored to the Australian environment should be considered for the exposure draft;
- Previous Board decisions which have not been impacted by changes to the IFAC Code should be carried forward, including additional Australian paragraphs and the use of Australian specific definitions where necessary;
- In order to remove unnecessary duplication from section 290/291 of the IFAC Code, alternative ways to present the requirements of sections 290 and 291 needs to be explored. The benefit of alternative approaches would be the removal of up to approximately 70 paragraphs from the revised APES 110;
- Better use of defined terms within section 290/291 to improve clarity of application, including a definition of other assurance engagements with this term being used to clearly distinguish the requirements contained in section 291 of the IFAC Code;
- The requirements relating to the preparation of general purpose financial statements be clarified to indicate that a Member in Business shall take reasonable steps to ensure compliance with an applicable financial reporting framework;

Material Presented

- Working draft of Review of IFAC Code (July 2009) showing existing APES 110 and IFAC requirements on a paragraph-by-paragraph basis (all sections excluding sections 290 and 291);
- Minutes of Taskforce meetings held on 29 June 2009, 14 September 2009 and 9 October 2009;
- IESBA Technical Staff Paper “Comparison of the Code of Ethics (Revised July 2009) to the Code of Ethics (Revised July 2006)”;
- APESB Technical Staff Paper “Preliminary Comparison of Sections 290 and 291 of the IFAC Code”.

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