

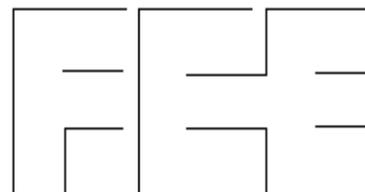
Date  
28 November 2003

Le Président

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des Experts  
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Mr James M. Sylph  
IFAC Ethics Committee  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, New York 10017  
USA



Dear James,

Re: IFAC Exposure Draft – Proposed Revised Code of Ethics for Professional Accountants

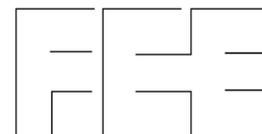
FEE (Fédération des Experts Comptables Européens – European Federation of Accountants) is pleased, as the representative organisation of the European accountancy profession, to have the opportunity to comment on the IFAC Exposure Draft – Proposed Revised Code of Ethics for Professional Accountants (hereinafter referred to as “the Code”). We welcome the extension of the framework approach as applied in Section 8 on Independence to the rest of the Code. FEE advocated a principles-based approach in its 1998 independence paper (“Statutory Audit Independence and Objectivity – Common Core of Principles for the Guidance of the European Profession – Initial Recommendations”) and wholeheartedly endorses this approach. It has formed the basis of the European Commission (EC) Recommendation on Statutory Auditor Independence and has been endorsed by the International Organisation for Securities Organisations (IOSCO) in its Principles of Auditor Independence published in October 2002.

FEE fully supports a principles-based approach to ethical standard setting, supplemented by appropriate guidance, restrictions and prohibitions. FEE believes this approach is best suited to a rapidly changing business environment. The professional accountant must conscientiously consider whether a proposed engagement involves threats which would, or would appear to a reasonable and informed third party, threaten observance of the fundamental principles. Where such threats exist, the professional accountant should put in place safeguards that eliminate the threats or reduce them to acceptable levels. Where it is not possible to reduce or mitigate the threats, the professional accountant should not carry out the work. By focusing on the underlying aim rather than detailed prohibitions, the principles-based approach combines flexibility with rigour in a way that is unattainable with a rules-based approach.

FEE is about to publish a paper on a “Conceptual Approach to Safeguarding Integrity, Objectivity and Independence throughout the Financial Reporting Chain” outlining how the conceptual approach could be used in setting ethical requirements throughout the financial reporting chain. For example, in developing ethical codes and independence requirements for members of the audit committee. We enclose an advance copy for your information.

FEE also welcomes the elevation of the Code to a “standard”. It is important, therefore that the Code works properly. Its status as a standard means that the Code will be much more important around the world. Major jurisdictions are acting to review existing practices so that they can maintain and enhance market confidence. FEE is concerned that uncoordinated action by national bodies, however well motivated, will not promote the necessary harmonisation of global markets.

FEE is nevertheless concerned about the usefulness and usability of the Code as currently drafted. We expand on this below. Section 8 of the Code is in a useable format which can (and has) been recommended to regulators such as IOSCO and the EC as a useable standard. It is important that the remainder of the Code is in a useable format such as Section 8 and therefore should be in line with



Section 8. The structure and the redundancies in the proposed Code results in it being longer and more complex than it needs to be, thus making it difficult to apply the Code in practice. It could not be adopted as it stands and requires further thought. This issue is of crucial importance to us given that the EC is currently revising the Eighth Directive, which will include the key principles on ethics and independence based on the framework approach. In this way, a legal underpinning is provided to the conceptual approach to ethics and independence so it is important that the Code works properly.

In addition to commenting on specific paragraphs in the document and suggesting amendments to the text, this comment letter includes our response to the questions set out in the Explanatory Memorandum to the proposed revised Code.

## **Comments on Questions**

*(a) Is the structure of the proposed revised Code understandable and useable?*

We have concerns about the structure of the Code, notably that its length and complexity may detract from its usefulness. Part of the complexity in our view results from the strict division of the Code into three parts, leading to unnecessary or inconsistent repetition and redundancies. There is a risk that Parts B and C will be used as stand-alone documents, which is not what is intended, with part A being ignored. In addition, it only partially recognises the reality that professional accountants in practice are also professional accountants in business by duplicating certain elements of C in B. It may therefore be helpful to construct the Code differently in that Part A sets out the high level principles and explains the threats and safeguards framework leaving the other parts to address only specific circumstances as well as indicating how these principles are to be applied in the specific circumstances for accountants in public practice and accountants in business. The duplication in Parts B and C should be removed and it should be made much clearer that both parts may be relevant depending on the circumstances. For Parts B and C, it should be made clear in Part A that their purpose is to assist respectively accountants in public practice and accountants in business to apply the principles set out in Part A. This would also avoid the perception that, for instance Part A is too public practice orientated as is the case in the current draft.

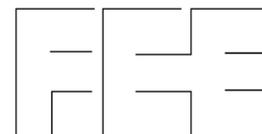
The Code should be sufficiently clear so that accountants know what to do in practice and a reasonable and informed third party can assess whether the principles have been properly applied. It is important that the profession can demonstrate to the world that a principles-based Code can work and is the best way of protecting the public interest.

Insofar as the current structure is concerned, we would like to make the following suggestions in relation to inconsistencies and redundancies.

There are items that are addressed on several occasions in the Code and also in Section 8. These items (e.g. fees) should at the very least be properly cross-referenced or preferably be consolidated. We realise that this may depend on how Section 8 will be integrated into the Code. The Code should be structured in such a way that this can be easily done, thus removing much of the material which is repeated in Section 8.

Instead of copying the principles set out in Part A into Parts B and C, in full the principles could be simply referred to: (a) integrity; (b) objectivity, etc. without repeating the supporting explanation. If there is a preference for a further need for repetition of the principles, this should only be in summary.

Many of the redundancies are not consistent between the different parts. It is not clear why certain elements of Part A are not repeated in Parts B and C or only repeated in Part B, whereas others are repeated in both sections. Are the repeated elements of Part A more important than the other elements of Part A? Furthermore, redundancies are occurring in different forms: under the form of a full repetition of the texts, a summary of the text or a cross-reference. In addition, paragraphs 1.6, 1.14 and 4.4 of Part B and 1.9, 1.17 and 6.9 of Part C refer to Part A whereas in all other areas of Part B and



C relevant aspects of Part A are repeated in full. See also our comments above regarding the structure.

We consider consistency in each of the parts and between the parts important. For example, the titles of the subsections are not aligned in the various parts: Part B, section 3 is labelled as Conflicts of interest whereas the comparable section in Part C, section 2 is called Potential conflicts. In Part B, a section on professional behaviour or on acting with sufficient expertise, is missing. The titles of the subsections need to be aligned and should show how the principles of Part A can be applied to each type of accountants.

*(b) Is the explanation of the framework approach sufficiently clear?*

Section 8 is understandable and readable as a standalone document. The current text of Parts B and C does not sufficiently clarify the application of the conceptual approach because the text refers mainly to the threats to compliance with the fundamental principles rather than discussing the nature of the threats and the possible safeguards. It is not helpful to only refer to Part A for safeguards. Parts B and C do not make sufficiently clear how the threats and safeguards approach works under the specific circumstances.

It would also be helpful to explain in greater detail how the framework should be applied in practice: what questions need to be asked and what are the principles at risk. Care should be taken to ensure that the principles do not become rules as the principles-based approach is predicated on accountants using their own judgement based on their analysis of the circumstances. For example in Part A, paragraph 3.2 is more akin to a rule rather than a principle and does not fully reflect the circumstances of business members. Moreover Section 8 will at some point need to be integrated into the Code. Much of the explanation of the framework approach in Section 8 could usefully be incorporated into part A which as drafted is not as comprehensive. We are of the opinion that the text needs to clarify that where there are no sufficient safeguards to reduce or eliminate a threat the only option is to decline the engagement. As such the prohibition is not a safeguard but a consequence. Within a framework approach if there is no sufficient safeguard to reduce or eliminate the threat the ultimate consequence is a prohibition. It is important that the Code is consistently worded.

The Code should be sufficiently robust for enforcement. We would therefore propose to add in the current text of paragraph 1.10 of Part A the sentence: "The framework is sufficiently developed and robust to ensure that the judgements of accountants are transparent and where appropriate capable of review by interested third parties for example quality assurance systems, oversight and disciplinary systems, or courts".

*(c) Are the fundamental principles sufficiently articulated?*

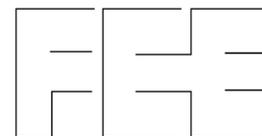
The fundamental principles are sufficiently articulated and defined.

Section 3 of Part A, however, needs to be further developed in that accountants in business cannot always be unbiased, but still need to act with objectivity and integrity. This clarification could be included in part C.

*(d) Does the guidance on specific circumstances contained in Parts B and C cover the appropriate activities and relationships in sufficient depth?*

See comments under (b)

Part A, paragraph 1.16 suggests two broad categories that safeguards fall into. It ignores specific safeguards that can be implemented by the individual. Examples of individual safeguards include



complying with CPD requirements, keeping records of contentious issues and approach to decision making, and using an independent mentor. Also, the section makes no distinction between strategic safeguards that professional accountants must have regard to and the specific ones that can be implemented. It would benefit from a fuller analysis of what safeguards exist and which ones can actually be applied.

The second example of safeguards within the client's systems in paragraph 1.18 of Part B should be deleted or replaced. The fact that the client has competent employees to make managerial decisions does not necessarily constitute a reliable (or adequate) safeguard since it is a subjective measure. It is possible that even competent employees may be unwilling to make important strategic decisions. We could accept the inclusion as a safeguard of having competent management with experience and seniority, since management has the ultimate responsibility. However, competent people can be unethical and non-competent people can be ethical. Moreover we suggest paragraphs 1.17 and 1.18 be combined.

In paragraph 2.2 of Part B the third example "Complying with relevant laws, regulations and best practice" should not be used as a safeguard in this context. Professional accountants are expected to comply with relevant laws and regulations. We believe that compliance with best practice could be mentioned as a safeguard, however compliance with relevant laws and regulations is a general implicit safeguard rather than a specific one to be applied to individual circumstances.

In paragraph 2.10 of part B we question whether the last bullet point "Discussing the issue with those responsible for the client's governance" is actually a safeguard since there is no action implied. The bullet point would at least need to explain why it is an effective safeguard. (The same applies to the penultimate bullet)

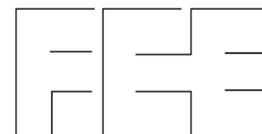
*(e) In certain circumstances, the 'ultimate' safeguard has been identified as a prohibition. Where such prohibitions have been identified, is this analysis appropriate?*

We consider the analysis to be appropriate.

However with respect to paragraphs 2.13 and 2.14 of Part B regarding the use of experts it is not clear to what extent the paragraphs apply in general or are meant to address specific circumstances. IFAC should clarify in its Code that the professional accountant should ensure that the total knowledge available, including that of the expert, is sufficient to comply with the fundamental principles before continuing his work. Therefore, consideration should be given as to whether the use of experts mentioned in 2.14 is a reliable and appropriate safeguard. If a professional accountant does not have the appropriate competence, there is a limit to the extent that he can use an expert. For example the auditor has to at least be able to assess the work of the expert and periodically check the expert's competence. The use of an expert over a long period may also create a familiarity threat. The explanation in the proposed Code is insufficient.

With regard to paragraph 4.8. of Part B where the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, it should be clearly stated that professional accountants in public practice should decline the engagement. Moreover the text of both paragraphs 4.7 and 4.8 is not clear and they should be combined. The last sentence of paragraph 4.7 should read: "If the proposed accountants are unable to obtain information either by communicating with the existing accountants or by other means, they should decline the engagement" (i.e. paragraph 4.8 should be deleted).

We also would like to refer to the use of wording at several instances in the Code such as "may", "try", "consider" which may give the appearance of being soft. We are of the opinion that the use of stronger terminology should be considered, where appropriate, or an explanation for the apparent flexibility built into the Code. Examples are paragraphs 1.25 of Part A, 4.7 and 4.8 of Part B. In Section 6 of Part B, Fees and Other Types of Remuneration, we would also recommend stricter wording in the sixth line of



paragraph 6.5. Here the word “may” is used, which is not appropriate because accepting referral fees or commissions does give rise to self-interest threats.

*(f) The IFAC Ethics Committee is considering an implementation date of January 1, 2006 for the proposed revised Code. Is this appropriate?*

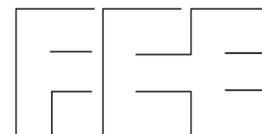
The implementation date of January 1, 2006 is appropriate. However, given that IASs must be applied in Europe by 2005, and the fact that section 8 comes into force on 31 December 2004, early adoption of the Code should be encouraged.

## **Other Comments**

### **1. Definitions:**

We underline the need for consistent definitions in all documents issued by IFAC be it standards on auditing (ISA) by the IAASB or the Code of Ethics, including Section 8 on independence. We recognise that some of the definitions are exclusive to Section 8 and may therefore not be easy to change. Below, we list some examples of inconsistencies:

- Assurance engagement: this definition needs to be updated for the results of the ED on Assurance Engagements: Proposed “International Framework for Assurance Engagements” and may need to include some explanation regarding the scope of the Framework. We would like to emphasise the critical importance of a clear definition of assurance engagement, as otherwise the risk of inadvertent breach of the IFAC independence code, through a misunderstanding, will be high. Therefore, to demonstrate compliance with independence requirements, it is vital that all non-audit assurance clients are identified and tracked, so as to avoid taking on as an assurance client one for which a firm has previously undertaken conflicting non-assurance work, and to prevent such work being taken on in the future, at least until the assurance engagement is completed. Thus in addition to audit clients, there is a need to manage independence very carefully for all non-audit assurance clients. In this respect we refer also to our comments on the scope of the assurance engagement in our letter of 30 June 2003 on Assurance Engagements, Proposed “Implementation Framework for Assurance Engagements” and Proposed ISAE 2000 “Assurance Engagements on Subject Matters other than Historical Financial Information”. (We enclose a copy for your information) Moreover there is the challenge of translation of the very complex description or definition of assurance engagement in the proposed revised Code of Ethics.
- Assurance team: this definition is different from ISA 220 on quality control. There may prove to be sound reasons for different definitions but these should be made clear. Ideally, the IAASB should be prevailed upon to consider whether their definition could be brought in line.
- Close family: it needs to be clear that this should be based on information the professional accountant can be reasonably expected to be aware of.
- Objectivity: the definition provided here is not in line with the definition in Part A, paragraph 1.14. It can also be questioned why objectivity would need to be defined being one of the key principles, and for example “integrity” not. We believe that the principles should not be repeated in the definitions section since they are fully covered in the main text.
- Practice: the definition should refer to public practice.
- Publicity: we question whether a definition is needed. The definition provided is not helpful.

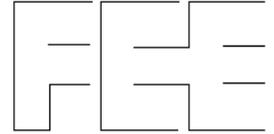


- Receiving accountant: according to the definition an external consultant is meant. Therefore it would be helpful if the receiving accountant could be renamed “external consultant”.
  - Related entity: in combination with the definition of audit client this seems to imply that related entities are only to be included for listed companies. As far as statutory audit is concerned we would prefer the position taken in the EC Recommendation on Auditor Independence in relation to statutory audit of financial statements where the term “affiliate” will include any undertaking, regardless of its legal form, which is connected to another by means of common ownership, control or management. The text would need to make clear that this would only apply for statutory audit clients and not for non-audit assurance clients. It is not our intention to widen the scope of independence requirements for non-audit assurance clients beyond the requirements already established in the IFAC Code of Ethics.
2. Paragraph 1.12 of Part A relates to inadvertently violating the Code. The last sentence of this paragraph: “If that happens, depending on the nature and significance of the matter, it may not compromise compliance with the fundamental principles as long as, once the violation is discovered, its effect is evaluated promptly, corrected when appropriate and any necessary safeguards are applied.” is unclear. An explanation of the situations where this can occur, is required rather than merely attempting to adapt a Section 8 situation. Some principles cannot inadvertently be violated, only consciously.
  3. Paragraph 1.14 of Part A and other paragraphs of the Code refer to business judgement, professional and business judgement at various instances. We consider it important that where judgement is exercised the accountant should adequately document his decision so that the judgement can be objectively reviewed.

The explanation in paragraph 1.14(b) Objectivity would be more useful if it were to read: “professional judgment when performing professional and business activities”.
  4. Part B paragraph 1.3 does not discuss the responsibilities of accountants in public practice whereas Part C paragraph 1.3 does so for accountants in business. Both paragraphs need to be brought in line.
  5. In paragraph 1.10 of Part B the first bullet point seems to be a subset of the second bullet point and may be redundant.
  6. The penultimate sentence of paragraph 2.14 is not clear as to which professional and ethical standards are referred to (those of the accountancy profession or those of the expert involved - we believe it should be those of the accountancy profession). The issue here is that the professional accountant should be satisfied that he/she can rely on the work of the expert. To that end we suggest that paragraph 2.14 ends with the words: “rely on the activities of such experts” and delete the remaining part of the paragraph.
  7. Contingent fees in paragraph 6.3 of Part B should be defined. This could be by way of a footnote using the definition in Section 8. Alternatively, the definition of “contingent fees” could be included in the definition section. At the very least paragraph 6.3 should refer to the appropriate paragraph reference in Section 8.

#### **Editorial comments:**

- It would be helpful if the paragraph numbers could have A, B or C in front of them as the current numbering system is confusing.
- Part A, paragraph 1.7 the word “is” should be changed to “could be”.
- Part A, paragraph 1.10, second sentence to read: “It is impossible to define every situation that creates such threats and specify the mitigating action.”



- Part A, paragraph 1.15(a) before the word “financial” the words “direct or indirect” are to be inserted. It would be helpful to use the same wording as in Section 8.
- Part A, paragraph 2.2 to insert the word “Accordingly” at the beginning of the paragraph.
- Part A, paragraph 3.2, second sentence to change the word “allow” to “result in”.
- Part B, paragraphs 1.7, 1.16 and 2.10: the terminology needs to be brought in line: “those in charge of client governance”, “those charged with client governance”, “those responsible for the client’s governance”.
- Part B, title above 2.13 e.g. “Use of experts” should be printed in italics.

If you have any further questions about our views on these matters, do not hesitate to contact us.

Yours sincerely,

David Devlin  
President

Encl.