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Basis for Conclusions: APES 110 Code of Ethics for Professional Accountants

Prepared by the Technical Staff of the Accounting Professional & Ethical Standards Board

BASIS FOR CONCLUSIONS:

APES 110 Code of Ethics for Professional Accountants

This basis for conclusions has been prepared by technical staff of Accounting Professional & Ethical Standards Board Limited (“APESB”). It has been reviewed and approved by the Board of Directors of APESB and is provided for the benefit of stakeholders to gain an understanding of the background to the revision of APES 110 *Code of Ethics for Professional Accountants* (the Code).

The basis for conclusions **does not** form part of APES 110 and is not a substitute for reading the Code.

Background

APESB originally issued the Code in June 2006 and subsequently made amendments in respect of the Network Firm definition (December 2007) and Corporations law changes (February 2008). The Australian Code issued by APESB is based on the *Code of Ethics for Professional Accountants* issued by the International Ethics Standards Board for Accountants (IESBA) of the International Federation of Accountants (IFAC). IESBA issued a revised Code in July 2009. In May 2009 APESB commenced a process to revise its Code to incorporate the changes in IESBA’s Code.

Revisions to the existing Code

The revisions to the existing Code have primarily occurred from the following four inputs and public consultations:

1. IESBA’s revisions to its Code (Reissued in July 2009);
2. APESB’s amendments to the revised IESBA Code;
3. APESB’s changes to the existing Code; and
4. APESB’s consideration of respondents’ comments to APES 110 ED.

1. IESBA’s revisions to its Code (Reissued July 2009)

IESBA commenced revision of its Code in December 2004 and completed three significant projects by July 2009 to strengthen the general provisions and in particular, the auditor independence requirements of its Code.

The three projects undertaken by IESBA and the key changes/issues addressed under each project are outlined below:

i. Independence I

The significant changes were:

- Extending the independence requirements for audits of Listed Entities to audits of all Public Interest Entities;

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- Expanding the partner rotation requirements for audits of Public Interest Entities to all Key Audit Partners (the Engagement Partner, the individual responsible for the Engagement Quality Control Review and other audit partners on the Engagement Team who are responsible for key decisions or judgments with respect to the Audit Engagement);
- Eliminating the existing flexibility for Firms with few partners to apply alternative safeguards instead of partner rotation to address the familiarity threat;
- Establishing a mandatory "cooling-off" period before a Key Audit Partner joins a former Audit Client that is a Public Interest Entity, or the individual who is the Firm's senior or managing partner (chief executive or equivalent) joins such an Audit Client;
- Updating requirements related to the provision of non-assurance services, including setting out additional guidance on the provision of tax services to Audit Clients;
- Providing additional guidance on independence requirements for certain assurance reports that are expressly restricted for use by only the users specified in the report; and
- Splitting existing Section 290 into two sections - revised Section 290, which sets out independence requirements for Audit and Review Engagements of Financial Statements, and a new Section 291, which sets out independence requirements for other Assurance Engagements.

ii. Independence II

The significant changes or issues considered were:

- Additional guidance on provision of internal audit services to an Audit Client;
- The size of fees received from an Audit Client that is a Public Interest Entity relative to the size of the Firm's total fees; and
- Additional guidance on providing services to an Assurance Client on a Contingent Fee basis.

iii. Drafting Conventions

This project considered the following significant issues:

- The use of the word "shall" to identify a requirement of the Code;
- Whether a temporary departure from a requirement should be permitted in certain circumstances;
- Revising the description of each category of threats;
- Clarifying the term "clearly insignificant";
- Clarifying the description of the conceptual framework approach; and
- Clarifying the terms "consider", "evaluate" and "determine" in the following manner:
 - "Consider" will be used where the Member has to think about a matter;
 - "Evaluate" will be used when the Member has to assess and weigh the significance of a matter; and
 - "Determine" will be used when the Member has to conclude and make a decision.

Subsequent to the completion of these projects, IESBA issued a revised *Code of Ethics for Professional Accountants* in July 2009.

2. APESB's amendments to the revised IESBA Code

APESB commenced a project in 2009 to revise its Code to bring it into alignment with the revised IESBA Code issued in July 2009. APESB issued an Exposure Draft (APES 110 ED 03/10) in August 2010 which used the IESBA Code as the base document and then incorporated the following changes to tailor it to the Australian environment:

- The addition of a Scope and Application section;
- The addition of paragraphs and definitions prefixed as AUST in APES 110. The additional definitions are of AASB, Administration, AuASB, AUASB, Auditing and Assurance Standards, Australian Accounting Standards and Member. The significant additional Australian paragraphs relate to inadvertent violations;
- The replacement of the words “professional accountants” in the IESBA Code with the word “Members”;
- The inclusion of defined terms in title case;
- The tailoring of the following IESBA defined terms to the Australian environment: Audit Engagement, Engagement Team, Financial Statements, Firm, Member in Public Practice and Review Engagement; and
- Unless strict requirements are met, APES 110 prohibits Members in Public Practice from providing accounting and bookkeeping services and preparing tax calculations for Audit Clients which are Public Interest Entities, even in emergency situations (refer paragraphs 290.172 – 290.173 and 290.185).

3. APESB's changes to the existing Code

In order to achieve closer alignment with the revised IESBA Code, APESB has removed references and paragraphs in the existing Code that incorporated Australian specific legislative requirements such as the *Corporations Act 2001* (particularly in relation to section 290) and privacy legislation (particularly in relation to section 140).

4. APESB's consideration of Respondents' comments on APES 110 ED

APESB received ten submissions from the professional accounting bodies, Firms, a Member, the Auditing and Assurance Standards Board (AUASB) and the Australian Securities and Investments Commission (ASIC).

In response to the comments received, APESB has made a number of changes to APES 110 ED. The following summarises the significant issues raised by respondents, and how APESB addressed them.

i. Inadvertent violations of the Code

The IESBA Code (and APES 110 ED) recognises that inadvertent violations of the Code do occur in practice and left it to the judgment of the Firm whether those violations are discussed with Those Charged with Governance. APES 110 ED contained additional Australian specific requirements which state that unless the inadvertent violation was trivial and inconsequential, the Firm must document and discuss it with Those Charged with Governance.

Some respondents raised concerns in respect of the proposed new Australian requirements. The respondents were concerned that the Australian requirements will be an additional burden on Firms, who in their opinion should have the ability to determine the extent, if any, of discussions required with Those Charged with Governance. On the other hand, ASIC is of the view that the proposed Code should not have any provisions dealing with inadvertent violations and that the IESBA provisions which recognise they occur in practice should be removed.

APESB considered the issue and determined to retain in the final Code the additional Australian paragraphs relating to inadvertent violations in APES 110 ED. APESB determined that these provisions strengthened the Code and create a safeguard in instances where inadvertent violations do occur. Firms should document inadvertent violations as a matter of best practice and the additional requirement imposed by the Code to discuss them with Those Charged with Governance (for example, an Audit Committee) is appropriate.

ii. Definition of Public Interest Entity

Some respondents supported the IESBA definition of Public Interest Entity and believed that no further Australian guidance was required. Some firms that responded to APESB's *Consultation Paper: Proposed revision of Code of Ethics for Professional Accountants* expressed the view that the definition of Public Interest Entities in Australia should only capture Listed Entities. However, this view is not consistent with IESBA's intended coverage under the *Independence 1* project (refer page 2)

The Board considered the definition of Public Interest Entity taking into account existing and proposed definitions in the Canadian, European Union and New Zealand jurisdictions. These jurisdictions have or are proposing to capture a broader range of entities in their respective definitions of a Public Interest Entity, not merely Listed Entities. This approach is consistent with IESBA's intention to extend the existing auditor independence requirements for audits of Listed Entities to audits of all Public Interest Entities (refer the *Independence 1* project on page 2).

For example, the definition of Public Interest Entity adopted by the European Union (EU) is as follows:

- *companies or other bodies corporate governed by the law of a Member State whose transferable securities are admitted to trading*

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on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC;

- credit institutions as defined in point 1 of Article 1 of Directive 2000/12/EC relating to the taking up and pursuit of business of credit institutions, and*
- insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC.*

ASIC believes that the Australian definition should be consistent with the definition of Public Accountable Entity in the Australian Accounting Standard AASB 1053 *Application of Tiers of Australian Accounting Standards*. ASIC notes that this approach is simple and reduces any possible confusion amongst Firms and Audit Clients in which there is public interest. The need to adopt a local definition was also supported by the professional accounting bodies. The professional accounting bodies stated that having an Australian definition is in the public interest as it should ensure that certain entities are always treated as Public Interest Entities rather than risking not having consensus amongst Firms.

Public Interest Entity is defined in section 290 of APES 110 in the following manner:

- (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.*

Public Accountability is defined in Appendix A of AASB 1053 in the following manner:

Public accountability means accountability to those existing and potential resource providers and others external to the entity who make economic decisions but are not in a position to demand reports tailored to meet their particular information needs.

A for-profit private sector entity has public accountability if:

- (a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or*
- (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.*

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In AASB 1053, the Australian Accounting Standards Board (AASB) has deemed that in the for-profit sector the following entities have public accountability:

B2 The following for-profit entities are deemed to have public accountability:

- (a) disclosing entities, even if their debt or equity instruments are not traded in a public market or are not in the process of being issued for trading in a public market;*
- (b) co-operatives that issue debentures;*
- (c) registered managed investment schemes;*
- (d) superannuation plans regulated by the Australian Prudential Regulation Authority (APRA) other than Small APRA Funds as defined by APRA Superannuation Circular No. III.E.1 Regulation of Small APRA Funds, December 2000; and*
- (e) authorised deposit-taking institutions.*

APESB considered whether the AASB's concept of Publicly Accountable Entity might form the basis of a modification to the Code and concluded that further work needs to be done to evaluate whether the AASB's concept is suitable in the context of the Code. In the meantime APESB's view is that the IESBA definition of Public Interest Entity should be retained in the Code, without modification at this stage, but will consider the definition of Public Interest Entity in the Australian context in 2011. It is noted that due to the transitional provisions the independence requirements in respect of Public Interest Entities only commence from 1 January 2012.

iii. Legislative references

APESB considered this issue at the time of issuing the APES 110 ED and determined to remove the paragraphs in the existing APES 110 that incorporated *Corporations Act 2001* requirements. This was done in order to achieve a closer alignment to the IESBA Code and to avoid the risk of having incomplete or inaccurate information about the Act in the Code.

Some respondents have raised concern that APES 110 ED does not assist readers in understanding the differences between the Code's requirements and those of the *Corporations Act 2001* and that this may lead to contraventions of the more stringent independence requirements of the Act.

APESB considered this issue and determined to adopt a footnoting system to warn readers of the Code where a more stringent independence requirement is imposed by the *Corporations Act 2001*. This mechanism will put Members on notice to refer to the Act and will assist in reducing potential contraventions of the independence requirements of the Act.

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iv. Prohibitions in respect of Accounting, Bookkeeping and Taxation Services provided to Public Interest Entities

The IESBA Code (and APES 110 ED) permits a Firm to provide services in relation to accounting, bookkeeping and preparing tax calculations to Audit Clients which are Public Interest Entities in an emergency situation (Paragraphs 290.172-173 and 290.185). ASIC's view is that this exemption is inappropriate as it creates a self-review threat and undermines the purpose of an independent audit. ASIC further stated that the exemption is unnecessary in Australia where there are a relatively large number of qualified accountants who can be engaged to provide these services. APESB agreed with ASIC's view and has removed this exemption dealing with emergency situations from the revised Code.

v. Convergence

Some respondents to APES 110 ED were of the view that no changes whatsoever should be made to the IESBA Code and that APESB should fully converge with the IESBA Code. While APESB supports the global convergence initiatives of the IESBA it recognises that the IESBA Code is a **minimum** requirement for IFAC Members in more than 120 countries. APESB is aware that many of Australia's international counterparts are modifying the IESBA Code to suit their particular circumstances.

APESB believes that the additional Australian requirements in the Code are appropriate and in the public interest.