



Six Month Review of Revised APES 110 *Code of Ethics for Professional Accountants*

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1. Executive Summary

1.1. Background

Accounting Professional and Ethical Standards Board (APESB) issued a revised APES 110 *Code of Ethics for Professional Accountants* (the Code) in December 2010. The new code aligns Australia's professional requirements with IESBA's revised Code issued in July 2009 and also includes Australian specific requirements relating to inadvertent violations (Breaches) and multiple threats to auditors' independence.

1.2. Reason for this report

In accordance with the constitution of APESB, a six month review needs to be performed for the Code to identify any issues reported by stakeholders. This report presents a review of the issues identified and the proposed action to address the identified issues.

1.3. Issues identified

The concerns identified by stakeholders since the Code was issued in December 2010 are summarised below:

1. Referral fee and commission examples in paragraph 240.7 of the Code refer specifically to a Member in Public Practice which has lead to confusion on interpretation by Members.
2. Temporary staff assignments that are prohibited by the Code are commonly part of public sector employment conditions and is an issue for staff of the Auditor General's office.
3. The Code has certain prohibitions in respect of employment with an audit client for Key Audit Partners. However, such employment is permissible in the public sector which may create conflicts for staff of the auditor general's office.
4. As currently drafted, the deeming provisions contained in paragraphs 290.16 – 290.24 in relation to Network Firm are likely to inappropriately deem small practices as part of a Network.

1.4. Summary of Recommendations/Actions Taken

The following is a summary of the recommendations in respect of the identified issues:

1. Redraft paragraph 240.7 in a more generic manner and remove specific reference to the recipient as a Member in Public Practice when the Code is revised next and inform the IESBA Technical Staff of this issue.

2. Develop an AUST paragraph under 290.142 to allow longer term secondments to occur for public sector employees and identify the specific safeguards that needs to be in place for this to occur.
3. Develop an AUST paragraph under 290.139 to allow an exception for employment of Key Audit Partner equivalents in the public sector subject to there being appropriate safeguards in place to eliminate threats to independence that may arise.
4. No amendments required in respect of the definition of Network Firm.

2. Review of Issues

2.1 Clarification of referral fee and commission examples

Issue

Examples contained in paragraphs 240.7 (first and second dot points) specifically refer to paying a referral fee to a Member in Public Practice and referring a client to another Member in Public Practice respectively:

The significance of the threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an Acceptable Level. Examples of such safeguards include:

- Disclosing to the client any arrangements to pay a referral fee to another Member in Public Practice for the work referred.
- Disclosing to the client any arrangements to receive a referral fee for referring the client to another Member in Public Practice.
- Obtaining advance agreement from the client for commission arrangements in connection with the sale by a third party of goods or services to the client.

Analysis of issue

Specific reference to a Member in Public Practice has led to confusion on interpretation by Members who are questioning whether the examples in paragraph 240.7 only apply where the recipient is a Member in Public Practice.

Stakeholders

Members of professional accounting bodies

Recommendation/Status

Confusion relating to interpretation of examples in 240.7 would be alleviated by redrafting the examples in a more generic manner. It is recommended that paragraph 240.7 be rewritten to remove specific reference to the recipient as a Member in Public Practice when the Code is revised next and inform the IESBA technical staff of this issue.

2.2 Temporary Staff Assignments

Issue

Paragraph 290.142 of the Code states that the Firm's personnel may not be lent to an audit client for other than a short time and shall not provide non-assurance services of a certain type or assume management responsibilities. In NSW, the Auditor General has arrangements for secondments with audit clients and, in many cases, they may relate to roles such as those mentioned above and, while temporary, may last for up to two years. Such secondments are considered a part of public sector employment conditions which the Auditor General is obliged to support. Further, in the opinion of the Auditor General, with appropriate safeguards in place, threats to independence can be reduced to an acceptable level.

Analysis of issue

Temporary secondments involving performance of the roles mentioned above are commonly part of public sector employment conditions. As currently drafted, paragraph 290.142 allows secondments under specified conditions and provides examples of safeguards available if a threat to independence arises. However, paragraph 290.142 provides that such arrangements as highlighted by the Auditor General will not be permitted. The Auditor General has suggested that an exception be made in the case of regulatory bodies where temporary staff assignments are expected as part of the broader public sector employment conditions and appropriate safeguards can be put in place.

The Code is derived from the international Code issued by IESBA. IESBA's Code does not directly address equivalent Auditor Generals offices. In Australia, Auditor Generals get included by virtue of limb (d) of the definition of 'Firm'.

Stakeholders

Members and the Auditor General's office.

Recommendation/Status

Threats to independence that may arise from the type of temporary secondments indicated by the NSW Auditor General can be managed with appropriate safeguards in place. It is recommended that a new AUST paragraph under 290.142 be developed to allow such secondments to occur by public sector employees (such as employees of an Auditor General) provided that specific safeguards are in place.

Technical Staff has organised a meeting with the Audit Office of New South Wales on 2 February 2012 to discuss the issue and collaborate in the development of an AUST paragraph to deal with this issue. It is proposed that acceptable safeguards are to be developed and evaluated for inclusion in this proposed paragraph.

2.3 Employment of Key Audit Partners with audit clients

Issue

Paragraph 290.139 of the Code indicates that in certain circumstances employment with an audit client will result in independence being compromised. The Code does not explain what the impact of this would be and what safeguards or steps (if any) can be implemented so the independence of the audit is not affected.

In the NSW public sector, there are instances when the equivalent of Key Audit Partners may take employment with audit clients. If the intent of the Code is to suggest that the only option in such circumstances is to relinquish the audit engagement, by law the Auditor General is unable to do this in the public sector.

Analysis of issue

Where the equivalent of a Key Audit Partner takes employment with an audit client that is a Public Interest Entity, such action is in contravention of the requirements of the Code. The Code as currently drafted does not provide detail of the impact of such employment or potential safeguards and steps that can be implemented so the independence of the audit is not affected in the public sector.

As noted in issue 2.2, this issue has arisen due to the Australian definition of 'Firm'.

Stakeholders

Members and the Auditor General's office.

Recommendation/Status

The prohibitions of paragraph 290.139 of the Code currently contradict the legal status of certain employment contracts in NSW. It is recommended that an AUST paragraph under 290.139 be developed to specifically allow such employment arrangements and

provide guidance on potential safeguards available to eliminate threats to independence that may arise.

Technical Staff has organised a meeting with the Audit Office of New South Wales on 2 February 2012 to discuss the issue and collaborate in the development of an AUST paragraph to deal with this issue. It is proposed that acceptable safeguards are to be developed and evaluated for inclusion in this proposed paragraph.

2.4 Definition of Network Firm

Issue

APES 110 deems a Firm to be a Network Firm if it satisfies any of the stated criteria in paragraphs 290.16 – 290.24. A stakeholder raised the issue that deeming as such means there is little point to the application of the reasonable and informed third party test contained in paragraph 290.15 and the consideration of particular facts and circumstances as suggested by paragraph 290.14. The stakeholder's key concern is the implications for a partner in a small firm that is deemed to be in a Network.

Analysis of issue

Paragraphs 290.16-290.24 do contain some deeming provisions. However, there are two limbs to each of these paragraphs that need to be satisfied prior to a Firm being deemed as being part of a Network. For example, paragraph 290.20 states as follows:

Where the larger structure is aimed at co-operation and the entities within the structure share the use of a common brand name, it is deemed to be a Network. A common brand name includes common initials or a common name. A Firm is deemed to be using a common brand name if it includes, for example, the common brand name as part of, or along with, its Firm name, when a partner of the Firm signs an audit report.

and Network is defined as follows:

Network means a larger structure:

- (a) That is aimed at co-operation; and
- (b) That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand-name, or a significant part of professional resources.

As currently drafted, paragraph 290.20 states that the larger structure must be aimed at co-operation and share the use of a common brand name. Both limbs must be satisfied to be deemed a Network. In practice, a small firm that is not sharing profits, costs, ownership, control, management, quality control policies, business strategies, or

significant resources is unlikely to be deemed a Network as suggested by the stakeholder due to the absence of co-operation.

Paragraph 290.14 of APES 110 states that whether a Network is created depends on the particular facts and circumstances of the situation. Paragraph 290.15 continues to say that the judgment as to whether the larger structure is a Network shall be made in light of whether a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the entities are associated in such a way that a Network exists. In the case of the small practitioner as highlighted above, in certain circumstances the application of paragraphs 290.14 and 290.15 are likely to lead to the conclusion that a Network does not exist.

Stakeholders

Firms and Members

Recommendation/Status

The Network Firm provisions contained in the Code are consistent with the IESBA Code and allow for the application of professional judgment when determining whether a Network exists. This network firm definition and its related provisions were originally issued by IESBA in 2006 and incorporated in the Australian Code in 2007. Due to the nature of the definition it is not advisable to make any amendments and the issue may be addressed by way of Member education.