



Organización Internacional de Comisiones de Valores  
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November 29, 2004

Ms. Jan Munro  
IFAC Ethics Committee  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, NY 10017

Re: Proposed Revised Code of Ethics for Professional Accountants

Dear Ms. Munro:

IOSCO's Standing Committee No. 1 ("SC 1") is writing to provide comments regarding the Exposure Draft of proposed changes to the IFAC Code of Ethics for Professional Accountants ("the Code"), and to communicate additional concerns relating to the Code.

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting, auditing, and professional standards. Our comments noted herein reflect those matters on which we have reached a general consensus among Standing Committee No. 1 members. These are not intended to include all the comments that might be provided by individual members on behalf of their respective jurisdictions.

In the Explanatory Memorandum for this Exposure Draft (ED), you advise that you are seeking comments only on the three questions raised in your exposure draft, and not on other portions of the current Ethics Code. In this letter, we provide our comments in response to your three questions, but we are concerned that the Exposure Draft limits the request for comments to only the three stated issues. We are therefore beginning our letter with additional general comments on matters which should be addressed by the Ethics Committee. These comments relate to both the content of the Ethics Code and the scope of its application.

### **General Comments on Additional Changes needed in the IFAC Ethics Code**

Events of recent years have underscored the importance of the auditor's role in providing assurance on the financial statements of listed companies in the global capital markets. In particular, these events have reinforced the importance of the auditor maintaining independence in fact, mind, and appearance. Financial reporting and auditing failures around the world have focused regulators and legislators, the accounting profession, and the general public on the need for improvements in auditing and ethical standards for auditors and enhanced audit quality control and oversight arrangements.

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In our April 30, 2002 letter to IFAC, we urged the Ethics Committee to conduct an ongoing review of the Code in light of events and conditions then occurring, to ensure that the Code would remain consistent with current expectations. Since the Code was issued in 2001, there have been many developments in auditor oversight and independence matters in countries around the world. In particular, Canada, France, Japan, the United Kingdom, the United States and other countries have created new bodies for oversight of auditors and/or issued new auditing and independence standards or recommendations. The European Union is undertaking a comprehensive program to improve audit quality assurance and strengthen auditor independence. IOSCO has issued Statements of General Principles for Auditor Oversight and Auditor Independence for consideration in all member jurisdictions seeking to evaluate and improve their requirements for auditors of public companies.

On January 29, 2004, we wrote to the Ethics Committee expressing our concern that “The current content of Section 8 of the Code does not, in our view, adequately reflect current public expectations for auditor independence. The Code needs to undergo further revision as a matter of urgency.”

Events and continued developments have continued to impact expectations and requirements for independence of public listed auditors. The content of the letters noted above expresses concerns as they existed at that time and these concerns have not lessened since. The current Ethics Code is not fully in compliance with the IOSCO General Principles. For example, it does not contain sufficient clear and specific prohibitions, nor does it specify requirements to document safeguards that have been applied to mitigate threats to independence, that would at least cover the areas of self-interest, self-review, advocacy, familiarity, and intimidation. Where safeguards are discussed, the guidance seems very general and/or incomplete.

Though we are not objecting to use of a threats and safeguard framework approach as one basis for securing auditor appearance in fact, mind, and appearance, we believe the actual application of safeguards to particular situations, as laid out in section 290, is not always clear or appropriate. Two examples are as follows:

- (a) Though stated in the framework that there may be situations when no safeguards are available to reduce the threat to an acceptable level, and ‘the only possible actions are to eliminate the activities or interest creating the threat, or to refuse to accept or continue the assurance engagement’ (290.16), this is not sufficiently carried through in the subsequent text and application to particular situations. It is not always clear, in some of the particular situations presented, that there may be certain situations where the threat is so great that the only possible action is as in 290.16.
- (b) Some of the actions put forward as safeguards to deal with particular threats are not, in themselves, safeguards but are merely additional publication or communication requirements (e.g. in section 290.162 it is suggested that discussing independence issues with those charged with governance is a safeguard).

We are aware that the Ethics Committee is engaged in a survey of independence requirements as part of a new project approved at the Ethics Committee meeting in September 2004. However, the survey planned appears to be only directed at asking member bodies in IFAC whether they find the current Ethics Code requirements understandable and adequate. Is the Ethics Committee planning to ask others who have an interest in auditor independence requirements, such as users of audits, and regulators, whether they believe current requirements are understandable and adequate? We believe that all concerned stakeholder groups should have the opportunity to provide an updated view of independence issues which warrant attention by the Ethics Committee.

Another example of our concerns is the Code's definition of "network firm". As we have previously stated, we do not believe it is appropriate to qualify the definition of a "network firm" by referring to "a reasonable and informed third party having knowledge of all relevant information" (emphasis added). By definition, when one is talking about the *appearance* of independence, most reasonable and informed third parties will not have knowledge of all relevant information dealing with the nature of the relationships that exist among national firms that operate as part of an international network.

We believe that the present definition is in obvious need of revision to ensure that its use, in both the Ethics Code and the IAASB's standards, achieves the intended effect. In our view, when the use of a globally-recognized firm name creates the appearance to the general public of a firm network, that should be sufficient to establish a network relationship regardless of whether knowledge of all relevant information (for example, the details of legal contract agreements among firms) might change that perception. The more restrictive definition that now exists in the Code could result in the scope of application of the Code's independence requirements being unduly limited or unclear in audits involving multiple firms.

Our concern with the current Ethics Code Exposure Draft increases when we read that the Exposure Draft is proposed to become "a standard", rather than "a model on which to base national ethical guidance". In order for the Ethics Code to become a high quality standard for use in audits of public listed companies, many further revisions would need to be made to meet the needs and expectations of investors in the capital markets.

We understand that the IFAC Ethics Code has been developed to apply to all accountants, not just accountants who are conducting audits of listed companies and/or are in jurisdictions with regulated markets. We also understand that there may be issues involved relating to the desire for member bodies to achieve compliance with the Code as part of their IFAC Member Obligations and an overall effort to improve practice over time. These considerations appear to be resulting in a very general Code with few specific requirements and prohibitions.

If IFAC has a goal that its Ethics Code will ultimately become recognized by regulators around the world as an independence standard, it may need to reconsider whether the current approach in the Code is consistent with this goal. Setters of international standards which seek to become "internationally accepted" will need to establish clear principles accompanied by rigorous, specific requirements that will support the conduct of high quality audits on a global basis. This means setting a high bar for auditing standards and independence and ethics requirements. If the independence requirements that need to exist for public listed company audits differ significantly from requirements for other professional accounting practice, perhaps separation of the necessary guidance should be considered. If trying to write a Code that can apply to everyone has the effect of obscuring or undermining what is expected in listed company audits, the result will not be acceptable.

The IFAC Ethics Committee has recently embraced a more open and transparent process and a number of other reforms that are designed to enhance standards setting in the public interest. The Committee has a valuable opportunity to advance the independence, professionalism, and quality of international ethics and independence standards. Responding to this opportunity will necessitate a clear definition of goals and a great deal of difficult work.

## Comments on Questions Raised in the Exposure Draft

### **Question (a) Are the changes to conform to the Assurance Framework appropriate and clear?**

As securities regulators, our interest is focused on the audits of listed companies and other public interest entities. With the reorganization of the Code and the related Framework changes, it was often difficult for us to identify exactly what has been changed and how it could affect public company audits.

The changes made in the Code specifically to conform to the Assurance Framework appear to be mostly minor changes in terminology. Therefore, if the test were only whether those changes conform to the revised Assurance Framework, one would have to say that they are appropriate. However, as to whether the changes are clear, we have an overall concern that some of the language in the new Assurance Framework seems less clear and easy to understand than the language which appeared previously in ISAE 100 and ISA 120.

We understand that the Assurance Framework has been produced by the International Auditing and Assurance Standards Board and not the Ethics Committee. However, the interplay between definitions in the Framework and International Standards on Auditing and the Ethics Code, and vice versa, is an important consideration in current standards development and application. Our concern over the clarity of the basic content in the new Assurance Framework leaves us unable to conclude that changes to the Ethics Code based on this Framework will be clear. We have already expressed a concern to the IAASB regarding the effect of some of the language in the new Framework on the Auditor Report auditing standard, ISA 700, under development. We urge the IAASB and the Ethics Committee to work together on ensuring that there is clarity and the ability for full understanding of both the new Assurance Framework and any resulting changes in the Ethics Code.

### **Question (b) Is it appropriate that the individual responsible for the engagement quality control review in the audit of a listed entity be subject to the same rotation requirements as the engagement partner?**

Yes, we welcome the revision that specifies that the person responsible for engagement quality control review should be subject to the same auditor rotation requirements as the lead engagement partner. However, we are concerned that the Code's coverage of rotation needs does not go far enough. As we have commented in previous letters, the IFAC Ethics Code is now only addressing rotation of two individuals on an audit engagement team, at a time when numerous jurisdictions around the world have already instituted or proposed requirements that call for rotation of additional members of the audit engagement team. The text dealing with rotation of these two individuals on an audit engagement for a listed company follows text that deals in general with the familiarity threat. The juxtaposition of the text with general application and the text dealing with listed entity audit engagements gives the strong message that consideration of the need for rotation starts and ends with these two persons.

The IOSCO Principles for Auditor Independence state that "standards of auditor independence should address specifically the need to ensure appropriate rotation of the audit engagement team such that senior members of a team do not remain in key decision-making positions for an extended period." We believe some reference should be made in the Code regarding needs for rotation beyond the engagement partner and the individual responsible for engagement quality control review.

**Question (c) Is the effective date appropriate?**

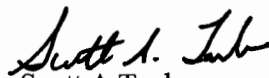
As we have previously urged the Ethics Committee to carry out additional revisions to the Ethics Code in a comprehensive project, our view is that it does not seem desirable to make a number of small changes piecemeal and therefore have multiple effective dates for revisions of different portions of the Code. We have no objection to setting the date shown (December 31, 2005) for the changes in rotation requirements described, but we remain concerned that much more revision of the Code needs to take place on a timely basis.

**Concluding Comments**

IOSCO Standing Committee No. 1 welcomes the recent IFAC reforms in the processes for setting standards and urges the Ethics Committee to undertake a comprehensive review and revision of the Ethics Code as it applies to listed company audits, as a matter of high priority. The Ethics Committee should work closely with the IAASB to address Framework issues, network firm and other key definitions, and all aspects of auditor independence requirements in the public interest. We also encourage the Ethics Committee to consult with national standards setting bodies, regulators, users of audits, and other organizations that are undertaking projects on independence matters or have expressed broad concerns about present independence requirements. Such action would enhance the opportunities to improve both international standards on auditing and the Ethics Code, and could also help to encourage global convergence in standards.

If you need additional information regarding the comments in this letter, please contact Susan Koski-Grafer or me at (202) 942-4400.

Sincerely,



Scott A. Taub

Chairman

IOSCO Standing Committee No. 1

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