



**INTERNATIONAL FEDERATION  
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## Agenda Item **6**

**Committee:** Ethics Committee  
**Meeting Location:** AICPA, New York, USA  
**Meeting Date:** February 14-15, 2005

### **International Convergence**

#### **Objectives of Agenda Item**

1. To discuss the Ethics Committee's strategy on convergence
2. To consider the IFAC policy on convergence and discuss the meaning of "equivalent standards" for Ethics

#### **Background**

IFAC is committed to international convergence as evidenced in both its mission statement and its Statements of Membership Obligations (SMOs).

IFAC's mission as set out in the Constitution is:

"to serve the public interest, strengthen the accountancy profession worldwide and contribute to the development of international economies by establishing and promoting adherence to high-quality professional standards, furthering international convergence of such standards, and speaking out on public interest issues where the profession's expertise is most relevant".

The SMOs, which were published in April 2004, confirm IFAC's requirement that member bodies support the work of IFAC's Public Interest Activity Committees (IAASB, Ethics Committee, Education Committee and the International Public Sector Accounting Standards Board) and the International Accounting Standards Board (IASB). The SMOs will form the basis of the IFAC Member Body Compliance Program. Member bodies will be required to perform self-assessments of their compliance with each of the SMOs including an assessment of actual standards in place in comparison to the relevant IFAC standards. The SMOs are included as reference material for the Committee as Agenda Paper 6-B.

The SMOs generally require member bodies to use their "best endeavors" to incorporate the pronouncements of the Public Interest Activity Committees (PIACs) and the IASB into the

national standards. Where development of national standards lies with third parties the member body should persuade the third party to incorporate the pronouncements.

The official date for adoption of International Financial Reporting Standards (IFRS) in the European Union is 2005. This has sharpened the focus on convergence. In 2004, Peter Wong, on behalf of IFAC and the World Bank, undertook a project to identify the challenges to adopting international standards and to communicate successful examples of how the international standards have been and are being implemented. The report on this project, titled “Implementation of International Accounting and Auditing Standards: Lessons Learned from the World Bank’s Accounting and Auditing ROSC Program”, is provided as reference material for the Committee as Agenda Paper 6-A.

The report found that the meaning of “convergence” and “adoption” are unclear and states:

“It is evident that international convergence is a process. This process could be enhanced by IFAC through greater clarification of the end result, i.e., the meaning of ‘adoption,’ and by the development of a more consistent and globally recognized measurement of international convergence.”

The report also recommends that, while consideration needs to be given as to how best to accommodate national laws and regulations, there should be greater consistency in approach by those adopting the international standards.

IFAC has undertaken a project to respond to the recommendation that IFAC further develop the concept of international convergence.

This agenda paper addresses two separate questions:

- Ethics Convergence Strategy – should the Committee have a strategy to try and eliminate differences between the Code and national ethical requirements; and
- Implementation of the Code – what do the standards in a national jurisdiction have to contain to be deemed “equivalent standards”

### **Ethics Committee Convergence Strategy**

The Ethics Committee terms of reference describe the Committee objectives as follows:

- To establish high quality ethical standards and other pronouncements for professional accountants that will protect the public interest and strengthen public confidence in the accounting profession.
- To promote good ethical practices to IFAC member bodies and to the public at large.
- To foster international debate on ethical issues faced by professional accountants.

With respect to the pronouncements that are issued by the Committee, the Code is described as follows:

*The Code of Ethics for Professional Accountants* which establishes a standard based principles of professional ethics for public accountants and provides a conceptual framework for applying these principles. No member body of IFAC or firm issuing reports in accordance with International Auditing and Assurance Standards is allowed to apply less stringent standards than those stated in the Code. However, if a member body

or firm is prohibited by law or regulation from complying with certain parts of the Code they should comply with all other parts of the Code.

At the December 2004 Consultative Advisory Group (CAG) meeting, it was noted that the Committee's terms of reference does not contain a statement regarding convergence. We were asked whether the Committee has a specific objective of convergence.

The IAASB interim terms of reference describe the objective of the IAASB as follows:

“...to serve the public interest by setting high quality auditing and assurance standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession. The IAASB achieves this objective by:

- Establishing high quality auditing standards and guidance for financial statement audits that are generally accepted and recognized by investors, auditors, governments, banking regulators, securities regulators and other key stakeholders across the world...”

The IAASB is developing a strategy to work with national standard setters, under which national standard setters would be encouraged to, for example:

- Align their work programs with that of the IAASB, subject to the work program of the IAASB;
- Work with the IAASB to remove incompatibilities with an existing or proposed ISA and the corresponding existing or proposed national standard in situations where a national standard setter is of the view that the ISA is inappropriate in the national context; and
- Accept the views of the IAASB, and the majority of other national standard setters on an issue, even though that view is not the preferred position of the national standard setter, unless such acceptance is not considered to be in the best interests of the national economy.

The intended outcome of the IAASB strategy would be the establishment of high quality standards that are accepted by key stakeholders.

In light of the difference between Ethics and the IAASB, the IFAC mission and the question raised by the CAG, Committee, members are asked to consider what the Committee's strategy should be with respect to convergence.

Once the final Code is approved it will become the standard to which member bodies and firms must adhere (see discussion below regarding SMO4). This requirement, when implemented (see discussion below), will bring national standards to the level of the Code but it will not address areas where national requirements are more extensive than the Code (“Code plus”).

Should the Committee develop a strategy to seek to get to a position where instances of “Code plus” are minimized? It is recognized that if such a strategy were adopted it would likely be a long-term strategy. While some member bodies establish ethical requirements this is not always the case. Even where member bodies do establish ethical requirements they are often subject to governmental and regulatory requirements and may even be supplemented by additional requirements, for example, additional requirements for listed entities.

***Action required***

Committee members are asked to consider whether the Ethics Committee should have an explicit convergence strategy and, if so, the matters that should be addressed by the strategy.

**Adoption and Implementation of IFAC Pronouncements**

Peter Wong's report states that the convergence process could be enhanced by IFAC through greater clarification of the end result, i.e., the meaning of 'adoption,' and by the development of a more consistent and globally recognized measurement of international convergence. Therefore, irrespective of the Committee's views on the need for a convergence strategy for the Ethics Committee, consideration needs to be given to the meaning of adoption of the Code.

The pronouncements issued by the various PIACs address different subjects (education, ethics, auditing and public sector accounting), are prepared for different audiences, follow different drafting conventions, and have different authority. For example:

- Education – the International Education Standards (IESs) contain bold lettering, with bold lettering reflecting the “essential elements” which are the minimum that accounting education and development programs are expected to contain. The grey (not bold) letter paragraphs elaborate or assist to interpret the bold letter paragraphs;
- IAASB – ISAs also contain bold and grey lettering, with the bold lettering reflecting “basic principles and essential procedures”, which should be read with the grey lettering. (The IAASB has issued an exposure draft and consultation paper proposing to clarify the drafting of ISAs – under the proposals professional accountants would have a responsibility to consider the entire text of an ISA in carrying out their work)
- International Public Sector Accounting Board – International Public Sector Accounting Standards follow the same drafting convention as the ISAs.
- Ethics Committee – the Code does not use bold and grey lettering. It requires the professional accountant to comply with specified fundamental principles, requires the accountant to identify, evaluate and address any threats to compliance with fundamental principles (¶100,5). The code also contains certain prohibitions on activities, for example a professional accountant should not make disparaging references or unsubstantiated comparisons to the work of others (¶150.2)

These differences in drafting convention and authority are reflected in the SMO relating to each PIAC.

SMO	MB to notify members of all pronouncements issued by PIAC?	What should be incorporated in national requirements?	MB to assist with implementation of requirements?
2: EDCOM pronouncements	Yes	Essential elements of the content and process of education and development on which IESs are based	Yes – international or national incorporating international
3: IAASB pronouncements	Yes	International Standards and related Practice Statements issued by the IAASB	Yes – international or national incorporating international
4: Ethics Committee pronouncements	Yes	Fundamental principles set out in the Code	Yes – IFAC Code and other pronouncements developed by Ethics Committee
5: IPSASB pronouncements	Yes	Requirements of IPSASs	Yes – international or national incorporating international
7: IASB pronouncements	Yes	Requirements of IFRSs	Yes – international or national incorporating international

SMO 4 recognizes that the authority of Section 8 of the Code, which deals with independence, differs from the remainder of the Code. Accordingly SMO 4 states that, no member body is allowed to apply less stringent standards than those stated in Section 8. However, if a member body is prohibited from complying with certain parts of Section 8 by law or regulation, it should comply with all other parts of that section. The SMO also recognizes that an outstanding exposure draft proposes to change the authority of the remainder of the Code to be consistent with Section 8. Therefore, the SMO states that, once the Code is final, the “best endeavors” obligation will be changed to reflect the new authority.

Both SMOs 3 (IAASB) and 4 (Ethics) require member bodies, in implementing their obligations of membership, to have as a central objective the convergence of national standards with international standards. Going forward, consideration should be given as to whether this requirement could be a requirement that applies to all the pronouncements dealt with in the SMOs.

Although IFAC’s ultimate objective is compliance with the pronouncements issued by IFAC and the IASB it is recognized that this could be achieved in different ways. Also the language used to describe this process is not consistent – indeed sometimes the same term is ascribed different meanings. Therefore, the IFAC Board has determined that it is necessary to develop a common understanding of how international convergence will be assessed. It is important that there is a common understanding among the PIACs because ultimately this will form the basis for assessment of compliance.

Therefore, IFAC staff has developed the following proposal:

*Convergence* is a process towards the adoption (and implementation) of equivalent standards.

*Equivalent standards* are national standards that may differ in detail from IFAC standards but their application would yield the equivalent or a similar result as the IFAC standards.

These definitions would be established at an IFAC-wide level with an aim to:

- accommodate the differences between the pronouncements issued by the various PIACs
- recognize that convergence is a process with either immediate results (i.e., adoption and implementation of the international standards) or that takes place over a period of time
- recognize that convergence could be a one-way process of aligning national standards with international standards, or a two-way process of aligning national standards and international standards.

***Action required***

Do Committee members have any concerns that the proposed IFAC definitions would not work for the Ethics Committee?

It is proposed that each PIAC determine what would be required from national standards for them to yield “the equivalent or a similar result” as the PIAC standard. There are five elements that need to be considered in this determination:

- Scope of convergence
- Authority
- Amendments to take account of national differences
- Timing

Each of these elements will be considered by each PIAC to determine what would be appropriate in terms of the pronouncements issued by the PIAC.

*Scope of Convergence*

Consideration should be given to which parts of the Code that, at a minimum, should be included in the international convergence project of a member body. Also we need to consider whether the Code is so interrelated with any other pronouncements of IFAC that those pronouncements would need to be included in the international convergence project of a member body.

The Code (section 130) addresses professional competence and due care. It notes that professional competence may be divided into two separate phases: attainment of professional competence; and maintenance of professional competence. It also states that continuing professional development develops and maintains the capabilities to enable a professional accountant to perform competently with the professional environments.

The Education Committee establishes Education Standards. These standards establish “essential elements that education and development programs are expected to contain and that have the potential for international recognition, acceptance and application.”

The Code is comprised of three parts:

- Part A describes the general application of the Code and contains the fundamental principles to which all professional accountants must comply;
- Part B illustrates how the conceptual framework is to be applied by professional accountants in public practice;

- Part C illustrates how the conceptual framework is to be applied by professional accountants in business.

Part A of the Code requires professional accountant to apply the conceptual framework to identify threats to compliance with the fundamental principles, to evaluate their significance and if the threats are other than clearly insignificant to apply safeguards to eliminate them or reduce them to an acceptable level such that compliance with the fundamental principles is not compromised. (¶100.2)

Parts B and C contain specific examples of application of the Code. These examples cover a wide range of areas and contain varying levels of requirements.

In some cases an example states that the accountant should or should not do something. For example:

“In marketing and promoting themselves and their work, professional accountants should not bring the profession into disrepute. Professional accountants should be honest and truthful and should not:

- Make exaggerated claims for the services they are able to offer, the qualifications they possess, or experience they have gained...” (150.2)

In other cases an example states that the threat created would be so significant no safeguards would be available to reduce the threat to an acceptable level. For example:

“If a firm... has a direct financial interest in a financial statement audit client of the firm the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level” (290.112)

In other cases, certain specific safeguards must be applied to reduce the threat to an acceptable level. For example:

“Safeguards that should be applied in all circumstances to reduce any threats created to an acceptable level include ensuring that:

- The audit client is responsible for internal audit activities and acknowledges its responsibility for establishing, maintaining and monitoring the system of internal controls...” (290.184)

In other cases certain safeguards should ordinarily be applied. For example:

“Depending upon the circumstances giving rise to the conflict, safeguards should ordinarily include the professional accountant...:

- Notifying the client of the firm’s business interest or activities that may represent a conflict of interest, and obtaining their consent to at in such a manner;...or
- Notifying the client that the professional accountant in public practice does not act exclusively for any one client in the provision of proposed services... (220.3)

***Action required***

Committee members are asked to consider which parts of the Code as a minimum should be included in national standards to be considered to be equivalent standards. Specifically:

- (a) Are the Education Standards so fundamental to the attainment and development of professional competence that convergence with the Code would also necessitate convergence with the Education Standards?
- (b) Would equivalent standards need to incorporate Parts A & B, or Parts A & C or Parts A, B & C – depending upon which types of professional accountants are governed by the member body?
- (c) Would equivalent standards need to incorporate the conceptual framework which requires the accountant to identify threats and apply safeguards?
- (c) Would equivalent standards need to pick up all of the examples contained in the Code? If certain categories need not be included why need they not be included?

***Authority***

The Code does not indicate that any parts of the Code have different authority. The preface states that:

“The Code of Ethics establishes ethical requirements for professional accountants. A member body of IFAC may not apply less stringent standards than those stated in this Code.”

National standards may be drafted using a different convention. For example a national standard setter might establish Part A as a “standard” and incorporate the application of the framework as “illustrative examples” that do not have the same authority as the standard.

***Action required***

Committee members are asked to consider whether two standards would be “equivalent standards” if they were drafted in a different convention which gave one a different level of authority.

***Amendments to Take Account of National Differences***

Peter Wong’s report notes that the adoption and implementation of the international standards in a country takes place in an environment that is affected by factors unique to that country, for example, the economy, politics laws and regulations, and culture. The report also:

- encourages national standard setters to identify the criteria for additional national requirements;
- states that such additional requirements should be limited to those necessary as the result of national laws or regulations. National best practices not dealt with in the international standard should be communicated to and considered by the international standard setters; and

- states that clear differentiation of the additional national requirements is preferred since it facilitates easy maintenance of the adopted international standards and the additional national requirements.

Staff has discussed what would be considered permissible modifications to PIAC pronouncements. Staff proposed the following:

1. Additions:
  - a. National legal and regulatory requirements
  - b. Requirements in addition to those in a PIAC pronouncement, but that are not inconsistent with the requirements in the PIAC pronouncement.
2. Deletions:
  - a. Deletion of an option (not really a good example within the Code but for example if the Code mandated application of either safeguard a or safeguard b, it would be permissible for a national standard setter to eliminate safeguard a);
  - b. If the application of a requirement in a PIAC pronouncement is not permitted by law of regulation (this is the existing position as outline in the preface to the Code).

***Action required***

Committee members are asked to consider whether national standard setters should be permitted to modify the Code.

If such modification is acceptable should it be restricted, and if so is the proposal appropriate?

Should the modifications be clearly differentiated?

***Timing***

Peter Wong's report notes that, in some instances, participants reported that their countries had adopted the international standards in effect at a particular date, but have not kept up-to-date with new and revised international standards that had been issued. In other instances it was found that national standard setters have different effective dates and transitional provisions from those of the international standard on which they are based.

While the report focused predominantly on ISAs and IFRSs the issue is also applicable to the Code. When Section 8 was issued in November 2001, it had an effective date for assurance reports issued after December 31, 2004. Also when the final Code is issued it will have a specific effective date.

***Action required***

Committee members are asked to consider the point at which a national standard setter could assert that it has equivalent standards to the Code.

### Material Presented

Agenda Paper 6	This Agenda Paper
Agenda Paper 6-A	Implementation of International Accounting and Auditing Standards: Lessons Learned from the World Bank's Accounting and Auditing ROSC Program
Agenda Paper 6-B	Statements of Membership Obligation 1-7

*Agenda Paper 6-A was previously sent to Committee members. It is provided here for reference purposes. While it is not necessary for Committee members to read the whole report it would be useful for members to read the Background and Summary of Principal Findings and Basic Assumptions found on pages 4-6 and Understanding the Meaning of International Convergence found on pages 7-10.*

*Agenda Paper 6-B is provided for reference purposes only. Where appropriate the relevant paragraph has been reproduced in this Agenda Paper; however, staff thought that some Committee members might wish to read the SMOs in their entirety.*

### Action Requested

1. Committee members are asked to consider the specific questions contained in the agenda paper.
2. Committee members are asked to consider whether it would be appropriate for the Planning Committee, based on the discussions at the New York meeting, to:
  - a. Draft a convergence strategy for the consideration of the Committee at its next meeting; and
  - b. Develop a proposal that describes what parts of the Code should be contained in the standards in a national jurisdiction for them to be deemed "equivalent standards". The proposal would be presented for discussion and approval at the Committee meeting.