INTERNATIONAL FEDERATION
OF ACCOUNTANTS
545 Fifth Avenue, 14th Floor
New York, New York 10017
Internet: http://www.ifac.org
Tel: +1 (212) 286-9344
Fax: +1 (212) 856-9420

Agenda Item
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Board International Ethics Standards Board for Accountants

Meeting Location: WpK, Berlin, Germany

Meeting Date: June 25-27, 2007

Independence

Objectives of Agenda Item

1. To discuss comments received on key issues raised on the Independence Exposure Draft, to consider the recommendations and alternative provided by ']the Task Force and to provide feedback to the Task Force.

Background

In December 2006, the IESBA issued an exposure draft (ED) proposing revisions to existing Section 290 and proposing a new Section 291. The exposure period was four months, one month longer than three month period required by IESBA due process because of the length of the ED. The ED period ended on April 30, 2007.

Comments have been received from the following:

Member Bodies of IFAC	32
Firms	8
Regulators	3
Government Organizations	3
Other	27
Total Responses	73

All of the comment letters received have been posted on the IFAC website and may be downloaded at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0075.

The Task Force[1] met on May 15th-16th and again on June 4th-6th to discuss the issues raised by respondents. The Appendix to this Agenda Paper contains a list of the comment letters which were received at by the date of the second Task Force meeting. Any comment letters which were received subsequent to this date will be sent separately to the IESBA members.

[1] Jean Rothbarth (chair), Geoff Hopper, Peter Hughes, Thierry Karcher, Neil Lerner, Andrew Pinkney and Volker Rohricht

Prepared by: Jan Munro (June 2007)

Key Issues

The Task Force has considered the comments received on overall key strategic issues and has developed issues papers on each of these issues. The key issues identified by the Task Force are:

- Principles/Rules
- Split of Section 290 and application to restricted use reports
- Definition of Entities of Significant Public Interest
- Partner Rotation and definition of key audit partner
- Definition of engagement team
- Taxation Services

These topics were selected because of either the volume of comments received on the topic or because direction on these topics is needed before the Task Force starts to develop detailed wording changes.

An issues paper has been prepared for the key matters on of these topics. Each paper provides:

- Background to the position proposed in the exposure draft together with the Board's reasoning for the position taken;
- A discussion of the comments received on key issues;
- Alternatives considered by the Task Force; and
- The recommendation of the Task Force.

In addition, for each issues paper there is a detailed cut and paste of all comments received on this issue. The detailed comments are the verbatim comments received. Each comment is identified by respondent. Appendix 1 to *this* agenda paper contains the legend for the abbreviations used to denote respondents.

It should be noted that while each issues papers discuss the key matters raised on that particular issue, the issues papers do not necessarily address every point which was made on that particular subject. Given the volume of comment, the lateness of some of the response letters and the timing of the June meeting, the Task Force has focussed on only key matters on which its needs direction before proceeding further. The Task Force will be meeting three more times before the October IESBA meeting (for a total of nine days) and will ensure that all matters are considered before presenting proposals at the October 2007 IESBA meeting.

Other Issues

The Task Force has noted other key points which were raised but has not yet discussed these comments in detail or developed recommendations on these matters. An overview of the comments received is presented for the information of the Board. The Task Force will consider these issues in more detail at future meetings and proposes to provide recommendations and further analysis (including the detailed comments received) at the October IESBA meeting.

Cooling-off Period

Proposed revised Section 290 (¶135-137) provides additional guidance on employment with audit clients that are entities of significant public interest. Under the proposed revisions, if a key audit partner or the individual who is the firm's Senior or Managing Partner joined an audit client that is an entity of significant public interest before a specific period of time (a "cooling-off period") had elapsed, independence would be compromised if the position with the client is:

- One that enables the individual to exert significant influence over the preparation of the entity's accounting records or its financial statements; or
- A director or an officer of the entity.

For key audit partners, the cooling-off period would be a period of not less than 12 months covered by audited financial statements for which the partner was not a member of the audit team for any part of the period. The ED stated that the self-interest, familiarity or intimidation threats would be so significant that no safeguards could reduce these threats to an acceptable level unless the entity had been through one complete annual audit cycle covering at least a 12 month period for which the former key audit partner was not involved.

Several respondents commented on this proposal. Comments provided on this topic were varied and included:

- The application to non-listed entities of significant public interest is too broad – restricting the ability of these entities to hire the most qualified person for the job could reduce the quality of financial reporting;
- The Code should adopt a safeguards approach with respect to non-listed entities of significant public interest such as requiring the individual to disassociate themselves from the firm and reviewing the audit plan;
- The period of cooling off is too complex should be a flat two years for both the CEO and key audit partners; and
- The requirement should apply only to the positions at the group level.

Valuation Services

Under existing Section 290, the guidance related to the provision of valuation services is the same for listed and non-listed audit clients. In both cases the self-review threat would be too significant if the valuation involves matters material to the financial statement and involves a significant degree of subjectivity. The IESBA reviewed these provisions and the ED proposed strengthening the provisions in two areas:

- For audit clients that are entities of significant public interest, the IESBA was of the view that a firm should not provide a valuation service if it would have a material effect on the financial statements. This enhanced safeguard is necessary to address the significant public interest in such entities. Accordingly, under the proposal a material valuation for an audit client that is an entity of significant public interest would compromise independence irrespective of the subjectivity associated with the valuation.

- To ensure consistent application of the Code, the IESBA proposed additional guidance on the meaning of significant subjectivity. Proposed revised Section 290 states that certain valuations do not involve a significant degree of subjectivity. This is likely to be the case where the underlying assumptions are determined by law or regulation or are widely accepted and when the techniques and methodologies to be used are based on generally accepted standards or are prescribed by law or regulation. In such circumstances, the results of a valuation performed by two or more parties are not likely to be materially different.

Of the 15 respondents who commented on the proposal that a firm should not perform a valuation service if it would have a material effect on the financial statements of an audit client that is an entity of significant public interest, four expressed explicit support for the proposal and 11 stated that they disagreed with the proposal because if there was no significant subjectivity involved in the valuation service there would not be an acceptable self-review threat. In addition some respondents stated that tax-only valuations do not give rise to the same threat to independence as financial valuations.

IT Systems Services

Existing Section 290 provides that IT services involving the design *and* implementation of financial information technology systems that are used to generate information forming part of a client's financial statements may create a threat that is likely to be too significant unless certain specified safeguards are applied. The existing section also provides that providing design *or* implementation services may create a threat. The IESBA reviewed these provisions and the ED proposed strengthening the guidance in two areas:

- For audit clients that are not entities of significant public interest, the ED states that either the design or the implementation of financial information technology systems that form a significant part of the accounting systems, or generate information that is significant to the client's financial statements, may create a threat that is likely to be too significant unless certain specified safeguards are applied.
- For audit clients that are entities of significant public interest, the ED states that, due to the level of public interest in such entities, a firm should not provide services involving either the design or the implementation of financial information technology systems that form a significant part of the accounting systems, or generate information that is significant to the client's financial statements.

Of the 14 respondents who commented on this proposal three were supportive of the strengthening of the requirements for entities of significant public interest, nine stated that the strengthening was not necessary, many stating that there was no evidence that the existing approach of mandatory safeguards had failed. One respondent expressed the view that the proposal for entities of significant public interest should be applied to all entities. One respondent stated that it was not possible to conclude whether the proposed amendment was appropriate or not.

Compensation

The ED acknowledged that compensation and evaluation arrangements may create a self-interest threat and detract from audit quality by providing an inappropriate incentive to focus on the selling of non-assurance services to an audit client. Therefore, the ED proposed that compensating or evaluating members of an audit team for selling non-assurance services to an audit client may create a self-interest threat. It further proposed that key-audit partners should not be evaluated or compensated in this manner because the threat created would be so significant that it could not be addressed by safeguards.
Of the 13 respondents who commented on this proposal, eight expressed support for the proposal, three were of the view that the restriction that key-audit partners should not be evaluated or compensated for selling non-audit services to an audit client should be expanded to cover all of the audit team; two were of the view that small firms should be permitted to apply safeguards to address the threat.

Special Considerations on Application in Audit of Small Entities and Developing Nations

The ED explicitly asked respondents to comment on whether, in their opinion, considerations regarding the audit of small entities had been dealt with appropriately in the proposed revisions to the Code. Respondents were asked to provide reasons if not in agreement, as well as suggestions for alternative or additional guidance.

The ED also welcomed comments on any foreseeable difficulties in applying the proposed provisions in a developing nation environment.

The IFAC Small and Medium Practices Committee (SMP) and the IFAC Developing Nations Committee have provided joint comments on the ED.

The SMP Committee represents the interests of professional accountants operating in small- and medium-sized practices and other professional accountants who provide services to small- and medium-sized enterprises. It develops papers on topics of global concern and provides input in the development of international standards and on the work of various IFAC boards and committees where appropriate.

The Developing Nations Committee supports the development of the accountancy profession in all regions of the world. The committee represents the interests of the developing profession, provides guidance and other resources to meet their needs, and seeks development assistance from the donor community for the strengthening of the accountancy profession in developing nations.

The comment letter is contained in Agenda Paper 3-P.

Material Presented

Agenda Paper 3	This Agenda Paper
Agenda Paper 3-A	Principles/Rules
Agenda Paper 3-B	Principles/Rules – Detailed Comments
Agenda Paper 3-C	Split of Code
Agenda Paper 3-D	Split of Code – Detailed Comments
Agenda Paper 3-E	Restricted Use – Detailed Comments
Agenda Paper 3-F	Entities of Significant Public Interest
Agenda Paper 3-G	Entities of Significant Public Interest – Detailed Comments
Agenda Paper 3-H	Partner Rotation and Definition of Key Audit Partner
Agenda Paper 3-I	Partner Rotation – Detailed Comments
Agenda Paper 3-J	Key Audit Partner – Detailed Comments
Agenda Paper 3-K	Engagement Team Definition
Agenda Paper 3-L	Engagement Team – Detailed Comments
Agenda Paper 3-M	Taxation Services
Agenda Paper 3-N	Taxation Services – Detailed Comments
Agenda Paper 3-O	Comments from SMP Committee and Developing Nations Committee

Action Requested

1. Board members are asked to consider the recommendations/alternatives presented in each of the agenda papers and provide feedback to the Task Force.

Appendix

As at June 1st the following comment letters had been received. The content of these comment letters is included in the detailed cut and paste of comments which accompany each of the issues papers.

Respondents Legend

AC	Audit Conduct (US)
ACAG	Australasian Council of Auditors General
ACCA	Association of Chartered Certified Accountants (UK)
AICPA	American Institute of Certified Public Accountants
APB	Auditing Practices Board (UK)
APESB	Accounting Professional and Ethical Standards Board – Australia
Australia	Australian Member Bodies – CPA Australia, The Institute of Chartered Accountants in Australia and National Institute of Accountants
Basel	Basel Committee on Banking Supervision
BDO	BDO
Blieden	Mervyn Blieden (US practitioner)
CACPA	California Society of Certified Public Accountants (US)
CAGNZ	Controller and Auditor General of New Zealand
CARB	Chartered Accountants Regulatory Board – Ireland
CCAB	Consultative Committee of Accountancy Bodies (UK)
CEBS	Committee of European Banking Supervisors
CGA – Alberta	Certified General Accountants - Alberta
CGA - Canada	Certified General Accountants – Canada
CICA	Canadian Institute of Chartered Accountants
CIMA	Certified Institute of Management Accountants (UK)
CMA	Society of Management Accountants of Canada
CNCC	Compagnie Nationale des Commissaires aux Comptes
CoCPA	Colorado Society of Certified Public Accountants (US)
Constantine	Constantine Assoices
CSOEC	Conseil Supérieur de l'Ordre des Experts-comptables
DnR	The Norwegian Institute of Public Accountants
DTT	Deloitte Touche Tohmatsu
EC	European Commission
E&Y	Ernst & Young
EFAA	European Federation of Accountants and Auditors for SMEs
FACPE	Federacion Arnegtina de Consejos Profesionales de Ciencias Economicas
FAP	Federation of Accounting Professionals (Thailand)
FAR	The Institute for the Accountancy Profession in Sweden
FEE	Federation des Experts Comptables Europeens
FSR	Foreningen af Statsautoriserede Revisorer (Danish Institute of State Authorized Public Accountants)
GAO	Government Accountability Office (US)

GSH	Grabel, Schnieders, Hollman & Co (US accounting firm)
GT	Grant Thornton
Hogan Hansen	Hogan Hansen (US accounting firm)
HKICPA	Hong Kong Institute of Chartered Accountants
HRH –CR	Hare, Russell & Holder – Claire Russell (US practitioner)
HRH – DH	Hare, Russell & Holder – David Holder (US practitioner)
IBR-IRE	Institut des Reviseurs d'Entreprises (Belgium)
ICAEW	Institute of Charted Accountants of England and Wales
ICANZ	Institute of Chartered Accountants of New Zealand
ICAP	Institute of Chartered Accountants in Pakistan
ICAS	Institute of Chartered Accountants of Scotland
ICAIndia	Institute of Chartered Accountants in India
ICJCE	Instituto de Censores Jurados de Cuentas de España
ICPAI	Institute of Certified Public Accountants in Israel
ICPAS	Institute of Public Accountants in Singapore
IDW	Institut der Wirtschaftsprufer (Germany)
IRBA	Independent Regulatory Board for Auditors (South Africa)
JICPA	Japanese Institute of Certified Public Accountants
KICPA	Korean Institute of Certified Public Accountants
KPMG	KPMG
KyCPA	Kentucky Society of Certified Public Accountants (US)
Lorenzi	David Lorenzi CPA (US practitioner
MACPA	Massachusetts Society of Certified Public Accountants (US)
MACPA2	Massachusetts Society of Certified Public Accountants second response (US)
Maresca	Joseph S. Maresca (US)
Mazars	Mazars
MIA	Malaysian Institute of Accountants
NASBA	National Association of States Boards of Accountancy (US)
NIVRA	Nederlands Instituut Van Registeraccountants (Netherlands)
NRF	Nordic Federation of Public Accountants
OCPA	Ohio Society of Certfied Public Accountants (US)
PAOC	Public Accountants Oversight Committee (Singapore)
PwC	PricewaterhouseCoopers
SAICA	South African Institute of Chartered Accountants
SCAA	Society of Chinese Accountants and Auditors
SMP/DNC	IFAC Small and Medium Practices Committee and Developing Nations Committee
Wolf	Wolf & Co (US accounting firm)
WPK	Wirtschaftsprueferkammer (German member body)

Known outstanding comment letters

IOSCO	International Organization of Securities Commissions