

**Minutes of the Meeting of the  
International Ethics Standards Board for Accountants  
CONSULTATIVE ADVISORY GROUP  
Held on April 3, 2006  
Princeton Club, New York, United States**

<i>Present:</i> Richard Fleck	Auditing Practices Board
Marc Pickeur	Basel Committee on Banking Supervision
Rebecca Todd McEnally	CFA Institute
Dr Harald Ring	Fédération des Experts Comptables Européens
Hilde Blomme	Fédération des Experts Comptables Européens
David Damant	IAASB Consultative Advisory Committee
Joyce Drummond-Hill	Institute of Internal Auditors
John Carchrae	International Organization of Securities Commissions
Susan Koski-Grafer	International Organization of Securities Commissions
Bella Rivshin	Public Company Accounting Oversight Board
Frederic Gielen	World Bank
David Brown	Public Interest Oversight Board
Richard George	IESBA (chair)
Frank Attwood	IESBA Member
Ken Dakdduk	IESBA Member
Neil Lerner	IESBA Member
Jean Rothbarth	IESBA Member
Jan Munro	IESBA Senior Technical Manager
Jim Sylph	IAASB Technical Director
<i>Regrets:</i> Gerald Edwards	Basel Committee on Banking Supervision
Ndung'u Gathinji	Eastern Central and Southern African Federation of Accountants
Federico Diomeda	European Federation of Accountants and Auditors For SME's
Jean-Luc Peyret	European Federation of Financial Executives' Institutes
Patricia Sucher	International Organization of Securities Commissions
Filip Cassel	International Organization of Supreme Audit Institutions
John Hegarty	World Bank

### **A. Welcome, introductions, agenda and minutes**

Mr. George welcomed all participants to the meeting and noted that, as agreed at the previous meeting, he would continue to chair the CAG meetings until such time as the CAG appointed their own Chair.

The minutes of the previous CAG meeting held on December 2, 2005 were approved as presented.

Mr George reviewed the agenda of the February 2006 IESBA meeting and noted that at the meeting the Board had made some decisions with respect to priorities. The Board had determined it was necessary to assign a priority to the independence project so that an exposure draft could be issued in 2006. To this end, the Board has scheduled a fourth tentative meeting to be held if necessary in December. In addition, the Board has decided to defer work on the project addressing ethical guidance for accountants when encountering fraud or illegal acts. It is anticipated that work will recommence on that project in early 2007. Mr George reported that these priority changes had been discussed with the Public Interest Oversight Board and they were in agreement with the changes. CAG members did not comment on the change in priorities.

The agenda for the CAG meeting was reviewed, no additional items were added.

### **B. and C. Independence**

Ms Rothbarth, Independence Task Force Chair, provided an overview of the considerations of the Task Force since the last presentation to the CAG in December 2005. She noted that the Task Force met in January and again in March and the CAG papers were presented in two parts. Agenda Series B contained the papers which the Task Force presented to the February IESBA meeting with the lead paper containing the direction which IESBA had given the Task Force. Agenda Series C contained material on non-audit services, including taxation services, which will be presented to the IESBA at its June meeting. She stressed that the series C agenda papers have not been discussed by the IESBA and, therefore, represent the views of the Task Force only. She further noted that the illustrative wording contained in series B and C is still a “work in progress” and the Task Force will refine the wording further before presenting it to IESBA for discussion in June. She noted that the Task Force will meet again twice before the June meeting and, therefore, the input of the CAG at this stage, would be very important to the deliberations of the Task Force.

The IESBA has a target of approving an exposure draft in 2006 and has, as previously noted, scheduled a tentative fourth meeting in 2006

Ms Rothbarth reminded the CAG of decisions which had been taken with respect to the independence requirements:

- The Task Force had reconsidered certain positions and benchmarked the existing requirements to other jurisdictions;

- The section will be split to separately address audits and other assurance engagements;
- When the final provisions are issued there will also be a separate “user-friendly” guide; and
- The language to be adopted in the revised sections will be more direct

#### *Partner Rotation*

Mr Dakdduk provided an overview of the partner rotations provisions in the extant Code and the views of the IESBA as to how these provisions should be amended. He noted that the existing Code contains the following rotation requirements for the audits of listed entities:

- The engagement partner and the individual responsible for the engagement quality control review are to be rotated after a specified period, generally seven years, and may not participate in the audit engagement until a further specified period, usually two years, have passed
- There is some flexibility over timing of rotation in certain circumstances – when the individual’s continuity is especially important to the audit client and when, due to the size of the firm, rotation is not possible or does not constitute an effective safeguard. If rotation does not take place, the extant Code requires that equivalent safeguards be applied to reduce threats to an acceptable level.

Mr Dakdduk reported that the IESBA had determined that:

- The partner rotation requirements should be extended beyond the engagement partner and the individual responsible for the engagement quality control review and should also address other key partners on the audit. It is important to rotate partners who have significant influence over the audit and are responsible for key decisions or judgments;
- The rotation period of seven years continues to be appropriate, for a global standard. IT strikes the appropriate balance between the need for a fresh look and the need for qualified accountants;
- A two-year time out period continues to be appropriate. However the Code should be clarified to state that there should be no meaningful activity on the audit engagement during the two-year time-out period. Accordingly, any transitioning activity would need to take place before the end of the seven year period; and
- With respect to flexibility of rotation, it should only be provided in very rare circumstances when the individual’s continuity is essential to the quality of the audit. There should be no flexibility for firms that have only a limited number of people to serve in positions requiring rotation. The safeguard of external review by a regulator was discussed by the Task Force and the Board. While some felt that this was an adequate safeguard, on balance the IESBA was of the view that because such a review was after the issuance of the audit report and financial statements (and possibly a few years after) it was not an effective safeguard.

Ms Koski-Grafer asked whether the Code would contain guidance for small audit firms who were not able to implement the safeguard of partner rotation. Mr Dakdduk responded that the Task Force had discussed the issue of rotation at length and while there was a diversity of views among the Task Force and the IESBA, on balance, the majority, were of the view that there were no safeguards that could be put in place to

replace partner rotation. While some thought that an external independent practice inspection (such as one performed by certain regulators) could be an effective safeguard, others were concerned that such an inspection was after the issuance of the audit report and could even be several years after. Accordingly, such members were of the view that this was not a sufficiently robust safeguard to address a familiarity threat for the audit of listed entities.

Ms Blomme indicated that the Fédération des Experts Comptables Européens Ethics Working Party had discussed the proposal and did not have a concern with removing the flexibility for small audit firms. Ms Koski-Grafer indicated that some IOSCO members may be of the view that requiring rotation for all listed entities was appropriate but others would likely be of the view that it would be problematic. Ms Todd McEnally noted that listed entities have a choice of which firm they appoint as auditor. Mr. Damant commented that it was important that the Code make it clear that the rotation requirement applied only to audits of listed entities.

Ms Rivshin questioned whether the rotation requirements would extend to “relationship” partners – that is partners who maintain regular contact with the client. Mr. Dakdduk responded that such a partner would be required to rotate if the individual had significant influence over the audit and was responsible for key decisions or judgments. Ms Koski-Grafer noted that while she welcomed that intension to extend the partner rotation requirements it was not sufficiently clear as to who would be captured by the term “other key audit partners” and, in particular whether this would include individuals such as relationship partners, marketing partners and advisory partners. Mr. Dakdduk indicated that the Task Force had focused on the key decisions made by partners but would also consider the points raised by the CAG.

Mr. Lerner noted that in a large firm the key decisions are often made, in effect, at the firm level. Ms Koski-Grafer noted that in large firms there might be several people who are decision makers and that it would be useful to have a robust debate on this issue. It was further noted that in small firms the structure would be very different.

Mr. Carchrae asked how the IESBA had formed the view that a two year time-out was sufficient and appropriate. Mr. Dakdukk noted that the IESBA had bench marked the position against other jurisdictions and had tried to balance the need for a fresh look, the expansion to other than the lead and reviewing partner and the need for competent individuals to serve in such positions. Mr. Carchrae asked for clarification as to how a two year time out period helped with respect to a limited talent pool. Mr. Lerner noted that with a two year time-out there will be a fresh set of judgments for two audit opinions. In addition, in many practical circumstances, the time-out period may be longer. Mr. Carchrae commented, while not commenting specifically on the appropriateness of a two-year time-out period, the shorter the period the greater the potential for the time-out period to be other than complete. He further noted that it was interesting to reflect whether a fresh set of eyes really gives a fresh set of judgments – for example, in the case of long term contract, the revenue recognition schedule would be determined and established in the first year of the contract. After partner rotation would the new partner’s

fresh look re-examine all of the judgments which had been made with respect to the revenue recognition?

Ms. Blomme noted that the Fédération des Experts Comptables Européens Ethics Working Party had discussed this and were of the view that it was difficult to mandate too frequent or too long a time-out period, especially given that research indicates a higher percentage of audit failure in the first year of an audit. She further questioned whether the Code would address situations where a partner leaves a firm to join another firm, taking a listed audit client with them.

Mr. Gielen noted that there was also a familiarity threat if a senior manager on the audit then becomes the partner. Mr. Dakdduk acknowledged this and noted that, in addition to specific partner rotation requirements, the Code required a consideration of familiarity threats created by long association of any senior personnel.

Mr. Damant cautioned that the Code needs to carefully strike the balance between the protection of the public interest and over regulation.

Ms Todd McEnally stated that it would be interesting if the PCAOB had any observations following the three year inspections of audits performed by small firms where there was no partner rotation.

#### *Partner Remuneration*

Ms Rothbarth noted that the existing Code does not address any threat to independence which might be created by partner remuneration schemes. She reported that the IESBA had considered the issue and was of the view that:

- The Code should explicitly address partner remuneration schemes;
- Partner remuneration schemes should be structured such that they do not call into question audit quality;
- The Task Force should have regard to the SEC and APB requirements with respect to drafting guidance related to remuneration for the selling of non-audit services;
- There should be no distinction between listed and non-listed entities; and
- The guidance should apply to all audit engagements and mirror the partner rotation requirements, that is address the engagement partner, the individual responsible for the engagement quality control review and other key audit partners. Other individuals would be addressed through the overall threats and safeguards approach.

Ms Todd McEnally noted that it could be argued that the provision of non-audit services has created issues with respect to auditor independence and she hoped that compensation schemes of firms were not tied to matters such as the size of the firm, the totality of fees generated and client retention. Ms Rothbarth indicated that the IESBA and the Task Force had considered these matters and had concluded that, in part as a result of the bench marking, that the focus should be on non-audit services. Mr Damant indicated that it was important to think also of the impact on the individual partner as well as on the firm. Mr Lerner indicated that in reality it is the firm which decides whether an audit client should be retained as opposed to an individual partner.

Mr Fleck indicated that it was important to consider the entire evaluation/appraisal structure as opposed to merely remuneration – without broadening the consideration the threat would not be appropriately addressed. Mr Carchrae noted that a remuneration system should stress and compensate for audit quality. Ms Munro noted that this is addressed in ISQC1 which states that the firm should establish policies and procedures designed to promote and internal culture based on the recognition that quality is essential in performing engagements.

*Public Interest Entities*

Ms Rothbarth noted that the existing Code states that certain entities may be of significant public interest because, as a result of their business, their size or their corporate status they have a wide range of stakeholders. It further requires that consideration should be given to the application of the framework in relation to the financial statement audit of listed entities to other financial statement audit clients that may be of significant public interest.

After consideration the IESBA had concluded that:

- The guidance in the Code should be strengthened;
- It is not possible to develop a single definition which would be appropriate in all jurisdictions;
- It would be helpful for the Code to have greater clarification on what is encompassed in a “wide range of stakeholders”;
- The Code should provide guidance to member bodies with respect to the types of matters which would be considered in determining whether an entity was a public interest entity including matters such as size and employment;
- The Task Force should consider the view that the reason there are differential requirements for public interest entities is because of the perceived threat to independence; and
- The Code should contain a presumption that all of the additional restrictions for listed entities would also apply to other public interest entities but there should be some flexibility for member bodies to not require a particular restriction if that can be justified in that jurisdiction.

Mr Damant noted that it was not possible to create an appropriate global definition of a public interest entity and that certain jurisdictions would establish a local definition.

Mr Pickeur expressed concern with not having a clear direction as to what would be considered to be a public interest entity. He noted that the EU has a list but that some jurisdictions might choose to add to the list. Ms Rothbarth stated that it was the intent of the Task Force to have examples of possible public interest entities but they would not be defined. Mr Pickeur noted that it was difficult to see why the independence requirements for an auditor of a large international bank would be different from the independence requirements faced by an auditor of a small listed entity. Dr Ring further noted that in the EU, credit unions are specifically addressed. Mr Pickeur asked whether the Task Force

had considered whether the EU definition could have global application. Ms Rothbarth indicated that the Task Force would consider this.

Ms Rothbarth indicated that the Task Force was developing the language but the intent was that auditors of public interest entities would face the same independence requirements as those for listed entities unless there was a particular reason why that was not appropriate and, if this was the case, an auditor would need to be in a position to justify the departure.

#### *Cooling off*

Ms Rothbarth noted that the existing Code states that independence may be threatened if a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement has been a member of the assurance team or a partner of the firm. The Code provides guidance on matters which will influence the significance of any threat created, requires the significance of the threat to be evaluated and, if other than clearly insignificant, requires that safeguards be applied to eliminate the threat or reduce it to an acceptable level. The Code does not contain any differential requirements for financial statement audit clients that are listed entities.

After consideration the IESBA had concluded that:

- The Code should contain a mandatory cooling off period before certain individuals may accept a particular position at an audit client that is a listed entity;
- The individuals would include the engagement partner, the individual responsible for the engagement quality control review and other key audit partners (which would be consistent with the partner rotation requirements);
- The affected positions at the client would be a director or an officer or an individual in a position to exert significant influence over the subject matter information (the financial statements). The IESBA considered whether this should be extended to individuals responsible for the subject matter (financial position, financial performance and cash flows) and concluded that this was more remote and accordingly, adequately addressed through the threats and safeguards approach;
- The length of the cooling-off period should be such that there is a “clean audit opinion” issued after the individual has left the assurance team and before he/she joins the client. For example, if an engagement partner signed the 2005 financial statements and performed some regulatory work in 2006, that individual could not join the client in a restricted position until the 2007 financial statements and audit report were complete; and
- The Code should contain an exemption for rare and unusual situations and for situations when, subsequent to accepting the position, as a result of a merger or acquisition, an individual found themselves in a restricted position.

Mr Damant commented on the illustrative wording noting that it was not clear. Ms Rothbarth noted that the Task Force continued to work on the illustrative wording to improve clarity and the cooling-off language was proving to be particularly problematic.

Dr. Ring noted that it was important that the wording make it clear whether the restriction would extend to subsidiaries.

Mr. Carchrae questioned the distinction between those who can exert significant influence over the subject matter information and those who can exert significant influence over subject matter. Ms Rothbarth responded that subject matter information in the context of an audit engagement meant the financial statements whereas subject matter was the financial position, performance and cash flows.

Mr. Fleck questioned what was meant by a “clean audit opinion.” Ms Munro clarified that this did not mean that there was a requirement that the audit opinion was unmodified, rather this was short-hand used by the Task Force to refer to the issuance of an audit opinion for which the partner had not been a member of the audit team.

Mr. Gielen questioned whether the cooling-off period would extend to directors and officers of significant subsidiaries of a listed audit client. Ms Rothbarth indicated that the requirement would cover such positions if the individual were able to exert significant influence over the financial statements at the group level.

Mr. Fleck noted that if any senior partner of the firm joined a listed entity audit client a threat could be created. He also questioned whether, in some circumstances, any safeguards would be available to reduce the threat to an acceptable level because the authority of the individual might be such that it was not possible to appoint a new partner with appropriate authority/seniority. Accordingly, it might be appropriate to have an additional statement in the Code noting that threats should be considered when any former partner or staff of the firm joins an audit client.

Ms Koski-Grafer questioned whether the Board was proposing such a requirement only because one jurisdiction had also included such a requirement. Ms Rothbarth noted that the Board had considered the benchmarking to many jurisdictions and was of the view that this matter was of such significance it should be addressed in the Code.

It was noted that this was an area of the Code where it would be useful to articulate the objective to be obtained.

#### *Management Functions*

Ms Rothbarth noted that the existing Code does not make specific reference to acting as management or acting in a management role. Instead there are several references direct or indirect to this issue.

After consideration the IESBA had concluded that:

- The Code should not contain a management threat as a new category of threat. IESBA is of the view that such a threat is a combination of existing threats in the Code – in particular self-interest, self-review and advocacy threats. The Code should make this clear;



- Management is responsible for many functions relating to stewardship and acting in the best interests of the owners of the entity and the results of these decisions are reflected in the financial statements. Performing a management function for an audit client aligns the auditor too closely to the client and therefore such functions should not be permitted;
- With respect to other assurance engagements the practitioner should not perform any management functions related to the subject matter of the assurance engagement. The practitioner may, subject to threats and safeguards, perform management functions that are not related to the subject matter of the assurance engagement;
- There should be no differentiation between small and large entities;
- It is not possible to have a definition of a management function but the Code should have a list of examples of what would be considered to be a proper responsibility of management and therefore would be a management function.
- Consideration would be given to whether there is a difference between authorizing a transaction and executing a transaction.
- The Code should contain some discussion of matters which would not be a management function but it should not contain a list of examples.

The CAG expressed general support for the proposed split between audit and other assurance services.

Mr. Pickeur questioned whether a chief-risk officer for a bank would meet the definition of a management function. He further noted that he would consider internal audit to be a management function which would therefore be prohibited and noted that the description of a management function seemed to focus too closely on the operations of the entity. Ms Rothbarth responded that the intent of the Board was to include people in key positions and agreed that further consideration would be given to the examples provided and whether the examples lined up appropriately with the description of a management function.

Mr. Damant indicated that it would be useful on exposure to ask a specific question regarding the application to small and medium sized entities.

#### *Non-audit Services*

Ms Rothbarth indicated that the IESBA had reviewed a benchmarking to other jurisdictions to consider whether the Code should contain any additional examples of non-audit services. In particular, the IESBA considered whether the Code should contain guidance on the provision of transaction related services. The IESBA noted that:

- There is a significant range of services that a firm might provide in connection with a corporate transaction as an investigating or reporting accountant. There is no generally accepted generic description for such services and it is not clear that a term such as “transaction related services” would necessarily be interpreted to apply to the same services in all jurisdictions.
- The services provided could be assurance engagements or non-assurance engagements;

- Transaction related services are clearly distinguishable from Corporate Finance services where the accountant acts as an advisor in connection with the management of a corporate finance transaction. Corporate Finance services might create an advocacy threat as well as the possibility that the auditor would be undertaking a management function, for example if it should commit the client to a particular transaction. These threats do not arise in transaction related work where the auditor is acting as an investigating or reporting accountant, required to act with demonstrable objectivity.
- These types of services are not generally addressed by other national codes/requirements; and
- The threats, if any, created by transaction related services are not unique to these services and neither are the safeguards.

Accordingly the IESBA has concluded that a separate section is not necessary for transaction related services and the section on Corporate Finance services should be revised to clearly differentiate it from Transaction Related services.

With respect to the existing non-audit services contained in the Code, Ms Rothbarth noted that the IESBA was of the view that:

- *Bookkeeping services* no significant changes were necessary. The position taken with respect to non-listed entities was generally appropriate but it should be clarified to indicate that for non-listed audit entities an auditor can prepare standard or adjusting journal entries provided that the client reviews the entries and understands their purpose. In addition, the Code should make it clear that accounting advice can be provided to listed and non-listed audit clients;
- *Valuation services* – the language should be clarified to refer to valuations that are incorporated in the financial statements and additional guidance will be provided on the meaning of “significant subjectivity”;
- *Temporary staff assignments* – this guidance should be changed to make it clear that assigned staff cannot provide non-audit services which would be otherwise prohibited, also the assignments should be short in duration and the loaned staff should not be a member of the assurance team.
- *Legal services* – no significant change is necessary but the wording will be edited for clarity.
- *Recruiting senior management* – the section will be revised to contain a restriction on recruiting for listed audit clients employees in a position to exert significant influence over the financial statements.
- *Corporate finance services* – in addition to the changes noted above on transaction related services a change would be made such that these paragraph apply only to audit clients, for other assurance clients the general threats and safeguards approach would apply.
- *Actuarial services* – many actuarial services are valuation services and are, therefore, already addressed by the Code. While it might be appropriate to expand the Code in the future to address actuarial services this was not a priority for this round of changes.
- *Not subject to audit procedures* – the concept that certain non-audit services would not impair independence if it is reasonable to conclude that the results of the services will not be subject to audit procedures will be incorporated in the Code. This relates to

instances where there is no self-review threat and does not apply to downstream entities.

Mr. Damant noted that in today's environment many corporations need significant assistance from their auditors with respect to adoption of IFRS. Ms Rothbarth noted that the Code does permit, even for listed entities, auditors to provide some assistance to clients.

Mr. Fleck stated that it would be important to carefully consider the application to public interest entities because such entities, in particular smaller non for profits, require assistance from their auditors.

Mr. Gielen noted that there would be issues with listed entities. For example, in some jurisdictions listed entities are very small and may have very few shareholders. Mr. Lerner noted that there might be such anomalies but it was preferable to develop the Code from a principles based approach as opposed to making specific accommodations within the Code for such anomalies. CAG members discussed whether the definition of listed entity appropriately captured all intended entities. It was agreed that the Board would give future consideration to this issue.

Dr Ring noted that while "an audit was an audit" the perception with respect to the audit of listed entities was different which is why there is a distinction between the requirements for listed and non-listed audit clients.

Ms Koski-Grafer noted that with respect to providing assistance to listed entities it was important that the services be limited to assistance, advice, counselling, training and the like. If auditors went further than this, including in emergency situations, they would be put in the position of auditing their own work.

Mr. Carchrae questioned what was meant by a valuation service which was "incorporated in the financial statements". For example, in the case of goodwill impairment where the valuation indicated that no write-down was required – would this still be considered to be incorporated in the financial statements? Ms Rothbarth indicated that this was the intent and the Task Force would reconsider the wording to make this clear.

Mr. Pickeur noted that there may be an issue with respect to independence if a firm provided a client with a model which generated a valuation. Ms Todd McEnally commented that it might dependent upon the nature of the model because there were, for example, some generic models which, with the appropriate assumptions would generate a valuation. Mr. Pickeur further noted that as accounting frameworks incorporate more valuations auditors will face more valuation issues than in the past.

#### *Tax Services*

Mr. Lerner noted that IESBA had a preliminary discussion of the issue at its February meeting but had not discussed the issue fully as the Task Force was still developing a

position with respect to taxation services. He noted that taxation services comprise a broad range of services including:

- Tax return preparation;
- Preparation of tax calculations to be used as the basis for the accounting entries in the financial statements;
- Tax planning and other advisory services; and
- Assistance in the resolution of tax disputes.

The Board was of the view that self-review and advocacy threats may be created by the performance of certain tax services. Working with informed management may mitigate such a self-review threat. He noted that the concept of “informed management” does not mean that management has to be an expert, rather the individual needs to have the capacity to make the significant judgments and decisions on the basis of the information and advice provided.

With respect to tax return preparation, Mr. Lerner noted that the Task Force was of the view that such services do not normally create threats to independence provided the firm is working with informed management and does not make management decisions because:

- The service provided are typically based upon facts already in existence or based on transactions that have already occurred;
- Subjective judgments are made within the constraints of the current tax law; and
- The tax return is subject to whatever review or approval process the relevant tax authority feels is appropriate.

With respect to preparing tax calculations of current and deferred tax liabilities, the Task Force was of the view that such services may create a self-review threat the degree of which would depend upon:

- The degree of subjectivity involved in the calculations; and
- Materiality.

If the threat was other than clearly insignificant, safeguards would be applied to eliminate or reduce any threat to an acceptable level.

With respect to preparing tax calculations at the level of the reporting entity, the Task Force was of the view that such services would generally create a self-review threat that was so significant no safeguards could address the threat. Providing such services to divisions or subsidiaries which were collectively immaterial would not be seen as impairing independence provided safeguards were applied to eliminate or reduce the threat to an acceptable level.

With respect to tax planning and other advisory services, the Task Force was of the view that a self-review threat may be created when the tax planning advice will affect matters that will be reflected in the financial statements. The significance of any threat would depend upon:

- Materiality;
- The degree of subjectivity;

- The extent to which the advice is supported by a private ruling or has otherwise been cleared by a tax authority; and
- Whether the effectiveness of the advice depends upon a particular accounting treatments or presentation and there is reasonable doubt about the appropriateness of the related accounting treatment.

In addition, the Task Force is of the view that where the effectiveness of the tax advice depends upon a particular accounting treatment or presentation and there is reasonable doubt as to the appropriateness of the treatment and the outcome of the advice will have a material impact on the financial statements the self-review threat created would generally be so significant no safeguards could reduce the threat to an acceptable level.

With respect to assistance in the resolution of tax disputes, the Task Force is of the view that an advocacy threat may be created when acting for the client in the resolution of a tax matters by representing the client before a public tribunal or court. If the amount was material to the financial statements, the Task Force is of the view that the threat created would be too significant.

Mr. Fleck commented that the subjectivity exists when the auditor is providing tax advice. Mr. Lerner responded that in some cases the subjectivity may not be great because the matter is well addressed by tax law. Dr Ring noted that related to the provision of tax advice, the situation is the same for both listed and unlisted audit clients, which should not lead to a prohibition in all cases.

Ms Koski-Grafer noted that it was important in the drafting to be clear as to what was the responsibility of an individual, the firm and a network firm. Ms Rothbarth agreed that the Task Force would consider this matter, not only with respect to taxation services, but with respect to all of the Section.

Ms Blomme noted that the Fédération des Experts Comptables Européens Ethics Working Party had discussed the proposals and had noted that there should not be a general prohibition as proposed by the Task Force. Such matters should be considered on a case by case basis and using the threats and safeguards approach, such tax services would create too significant a threat in certain cases but not in others. Also, it was noted that such general prohibition does not appear to exist in the other Independence Rules considered, except for France. Mr. Lerner noted that was the case but expressed the view of the Task Force that tax services were a significant non-audit service and as such should be explicitly addressed in the Code.

CAG members questioned whether the Code should explicitly address why there were differing requirements for listed and non-listed entities. It was agreed that the principle related to perception and public policy. It was suggested that this matter be addressed in the Code.

Ms Rivshin questioned what was meant by “reasonable doubt” and whether the Code would contain any guidance on what this meant. Mr. Carchrae questioned whether any

threshold was necessary and perhaps a threat was created if there was doubt as to the appropriateness of a particular accounting treatment. Mr. Fleck noted that the APB had used the term reasonable doubt and the link was to the fact that the auditor has to be in a position to express an opinion on the financial statements. It was agreed that the Task Force would reconsider the term “reasonable doubt”.

Mr Fleck noted that when assisting a client before a tax tribunal the first public hearing could be merely a fact finding one and it might not be until the next level that advocacy is an issue. Mr. Brown noted that, even in a fact finding situation, the might be the perception that an auditor is stepping into the shoes of management.

#### *Internal Audit*

Ms Rothbarth noted that the Board did not attend to address internal audit services at this time. On balance, the Board was of the view that the position taken in the Code is appropriate – with appropriate safeguards internal audit services can be provided. The Board recognizes that some feel differently and some jurisdictions have a more stringent approach. Accordingly, the Board is of the view that a more thorough analysis of this service is required and the subject will be addressed in the next round of changes to the Section.

Mr. Carchrae commented that the question was whether an audit team would bring to bear the same level of professional scepticism when internal audit work was performed by the firm as opposed to the client.

It was agreed that the matter would not be addressed at this time.

#### *IT Systems Services*

Ms Rothbarth noted that the Board was of the view that the restriction for listed entity audit clients should be changed to address design *or* implementation of IT systems, as opposed to design *and* implementation of IT systems which is the current position taken in the Code. In addition, for non-listed audit clients, the safeguards outlined in the Code would be mandatory – namely:

- The audit client acknowledges its responsibility for establishing and monitoring a system of internal controls;
- The audit client designates a competent employee, preferably within senior management, with the responsibility to make all management decisions with respect to the design and implementation of the hardware or software system;
- The audit client makes all management decisions with respect to the design and implementation process;
- The audit client evaluates the adequacy and results of the design and implementation of the system; and
- The audit client is responsible for the operation of the system (hardware or software) and the data used or generated by the system.

Dr Ring questioned whether the threats created by designing IT systems were the same as for implementation, in that implementation services might bring the firm closer to the financial statements.

Ms Koski-Grafer stated that it was important to look at implementation of pre-packaged software because of the significant element of personalization which was available.

#### *Responsibility*

Ms Rothbarth noted that the Task Force has considered whether the clarity of Section 290 would be improved if it assigned specific responsibility for independence requirements. She noted that ISA 220 does require the engagement partner to form a conclusion on compliance with independence requirements and that the Task Force was of the view that this should be incorporated into Section 290. Mr. Fleck noted that the Code is not always clear as to who is responsible for the independence considerations.

Ms Rothbarth thanked all CAG members for their valuable input and indicated this would be carefully considered by the Task Force.

#### **D. Network Firms**

Mr. Attwood, Network Firm Task Force Chair, presented the proposed changes to the definition of a network firm. He reminded the CAG that the definition is relevant for independence purposes in that firms within a network are required to be independent of all audit clients of the network. The existing definition was felt to be too narrow in that it gave insufficient recognition to the importance of how firms present themselves.

Mr. Attwood reported that the IESBA, at its February meeting, had discussed proposed changes to the exposure draft to respond to comments received. The major changes were:

- Alignment to the EU 8th directive language;
- Greater clarity as to what is mean by being part of a larger structure; and
- More guidance on the meaning of sharing common quality control policies and procedures.

The Task Force had also considered the effective date of the revision. There is a need for firms to communicate the changes throughout the network and to establish cross border mechanisms for the identification and reporting of audit clients. Therefore, the Task Force would be recommending to the IESBA an effective date for December 31, 2008 audits – which would give firms 18 months to implement the new requirements.

The issue of re-exposure was raised. Mr. Attwood noted that the Task Force was of the view that re-exposure was not warranted because there had not been substantial change to the document. The most significant change was to align the definition to the EU language and this change had been made in response to comments received on exposure. Ms Koski-Grafer noted that re-exposure would provide the IESBA with the opportunity to ensure that there were no unintended consequences of the changes. Dr. Ring commented that there might not be a need for re-exposure. He was very supportive of the further alignment of the network definition to the definition in the proposed Statutory Audit

Directive. He also pointed out that there might be a need for further practical guidance, e.g. as far as the impact of the network definition on the changes to the independence section of the Code.

### **E. Operational Matters**

Mr George reported that after the December 2005 CAG meeting a summary of matters discussed in the afternoon session had been circulated to all CAG members, to provide an opportunity to comment on the issues raised. All comments received had been circulated to all CAG members.

Mr George reported that the terms of CAG Terms of Reference and Roles and Responsibilities of the CAG chair (presented in Agenda Papers E.2 and E.3 respectively) had been reviewed by the PIOB. The CAG members approved these documents in final form.

Mr George noted that, in response to issues raised at the December CAG meeting, two initiatives, with the support of the PIOB had been put in place:

- Firstly, consistent with the IESBA terms of reference, three observers will be appointed by the IFAC Board, in consultation with the PIOB. The observers will have the privilege of the floor, participate in projects but will have no vote. The observers will be appointed in 2006; and
- Secondly, when appointing the new voting members to IESBA and considering those put forward for re-appointment, the Nominating Committee will give particular regard to qualified individuals who are non-practitioners and to non-accountants.

These steps will rebalance the composition of the Board and provide more input from non-practitioners and non-accountants.

Mr George further reported that when he met with the PIOB in late March, they expressed their disappointment that the CAG had not felt able to appoint a chair from amongst its own members. While they recognized that the CAG had wished to discuss structural issues, including composition of the Board, the PIOB was of the view that these matters should not delay the selection of a chair.

Mr Brown indicated that the PIOB does recognize the need for more non-practitioner participation on the IESBA and has met with the IFAC Nominating Committee to discuss this matter. In addition, the PIOB was considering whether the IESBA should have an additional public member. He reiterated the PIOB's view that these structural issues should not preclude the CAG from selecting a chair from amongst their own members.

The CAG discussed whether they were in a position to select a chair. It was noted that while there was still work to be done with respect to the composition of the CAG itself, in light of the desire of the PIOB to have a chair appointed, and the two initiatives with respect to the composition of the IESBA, the conditions were now such that it would be appropriate to appoint a chair.



Mr George indicated that he had reflected on the views expressed by CAG members in the fall during the early discussions of the appropriate characteristics of a CAG chair. In addition to having the time and support of the CAG it was noted that a desirable characteristic was that the individual not be a practicing accountants and possibly be someone from outside of the profession. He further indicated that, in light of these factors, he had approached Mr Fleck to determine whether he would be willing to serve as CAG chair. Mr Fleck had consulted with the Financial Reporting Council and had indicated that, if he had the support of the CAG, he would serve as Chair. In Mr Fleck's absence, the CAG members discussed the proposal and all members present expressed strong support for appointing Mr Fleck as Chair noting that he clearly had the appropriate qualities and background to serve as Chair. CAG members stated that because the matter had been raised at the meeting there had not been an opportunity for members to consult with the respective organizations. Accordingly, it was agreed that members would be provided the opportunity to consult and would then be in a position to confirm the views expressed at the meeting.

*Post meeting note* – CAG members consulted with organizations and unanimously confirmed their support for the election of Mr Fleck as Chair. On May 2, 2006, IFAC issued a press release approving this appointment.

**F. Next meeting date**

The next meeting of the Ethics CAG will be September 13<sup>th</sup>, 2006 in Toronto.