
IESBA – INDEPENDENCE APRIL 2006 CAG COMMENTS

CAG Comment	TF Response
Partner Rotation	
Mr. Damant commented that it was important that the Code make it clear that the rotation requirement applied only to audits of listed entities.	Done – see ¶290.150 Agenda Item D.2
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.	See discussion under partner rotation Agenda Item D.2
Ms. Blomme 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.	The Task Force considered this matter and concluded that while it is not specifically addressed in the Code it is adequately covered by the general guidance in Agenda Item D.2 ¶290.149. The Task Force is not proposing further changes.

CAG Comment	TF Response
Public Interest Entities	
<p>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 bank would be different from the independence requirements faced by an auditor of a 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.</p>	<p>See discussion under Entities of Significant Public Interest – Agenda Paper D</p>
Cooling-off	
<p>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.</p>	<p>The Task Force has revised the language – see discussion under cooling off Agenda Paper D</p>

CAG Comment	TF Response
Cooling-off	
<p>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.</p>	<p>The Task Force has drafted guidance indicating that if a senior partner joins a client a threat may be created (Agenda Item D.2 ¶290.140). Section 290 also indicates that a threat might be created if a member of the audit team, a partner or former partner of the firm joins an audit client (whether or not it is an entity of significant public interest) Agenda Item D.2 ¶290.135. See also discussion in Agenda Item D under heading cooling-off.</p>
<p>It was noted that this was an area of the Code where it would be useful to articulate the objective to be obtained.</p>	<p>Agenda Item D.2 ¶290.134 indicates that self-interest, familiarity and intimidation threats might be created.</p>
Management Functions	
<p>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.</p>	<p>The examples of management functions include:</p> <ul style="list-style-type: none"> • Setting policies and strategic direction; • Preparing and fairly presenting the financial statements in accordance with the applicable financial reporting framework; • Designing, implementing and maintaining internal control; • Deciding which recommendations of the firm or other third parties should be implemented; and • Authorizing transactions. <p>See also discussion in Agenda Item D.2 under management functions.</p>
<p>Mr. Damant indicated that it would be useful on exposure to ask a specific question regarding the application to small and medium sized entities.</p>	<p>This will be included in the explanatory memorandum that will accompany the exposure draft.</p>

CAG Comment	TF Response
Non-audit services	
<p>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.</p>	<p>The Task Force has considered this when revising the guidance and developing the guidance on what constitutes an entity of significant public interest. The TF is of the view that the proposed approach strikes the appropriate balance.</p>
<p>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</p>	<p>The Task Force has discussed this and it is proposed the issue will be addressed in Independence Phase 2.</p>
<p>Ms Koski-Grafer noted that with respect to providing assistance to listed entities it was important that the services be limited to assistance, advice, counseling, 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.</p>	<p>The Task Force believes that the guidance indicates that such assistance is limited in this way – see discussion under Agenda Item D.1 and, in particular, the following paragraphs in Agenda Item D.2 ¶¶290.165-168, 170-171; 177; 178-190.</p>
<p>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.</p>	<p>The Task Force is proposing to replace this phrase with “has a material effect on the financial statements” – the TF is of the view this would include goodwill impairment valuations. See Agenda Item D.2 ¶¶173-175 and 177.</p>
<p>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 depend upon the nature of the model because there were, for example, some generic models which, with the appropriate assumptions would generate a valuation.</p>	<p>The Task Force considered this and concluded that if such guidance is needed it will be addressed in Independence Phase 2</p>

CAG Comment	TF Response
Non-audit services	
<p>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 commented that it was important that an auditor carefully explain the consequences of alternative treatments – without such an explanation, management would not be in a position to make the decision and the auditor might be stepping into the shoes of management</p>	<p>The Task Force believes this concept applies more broadly that tax and accordingly has addressed this under the discussion of management functions. ¶290.161 (Agenda Item D.2) states “The risk is further reduced when the firm gives the client the opportunity to make judgments and decisions on the basis of an objective and transparent analysis and presentation of the issues.”</p>
<p>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.</p>	<p>The Task Force is of the view that the responsibility for a particular action may differ depending upon the size, structure and organization of a firm. ¶290.5 (Agenda Item D.2) states that firms should have policies and procedures to assign responsibility for identifying and evaluating threats to independence and applying appropriate safeguards to eliminate the threats or reduce them to an acceptable level.</p>
<p>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</p>	<p>See discussion under Entities of Significant Public Interest – Agenda Paper D</p>

CAG Comment	TF Response
Non-audit services	
<p>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”.</p>	<p>The Task Force is of the view the term reasonable doubt is the appropriate threshold – for other tax advice a threats and safeguards approach would be applied – see discussion under Non-audit services in Agenda Item D.</p>
<p>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.</p>	<p>The Task Force believes that for audit clients which are entities of significant public interest a firm should not provide IT services which involve either design or implementation, See discussion under Non-audit services in Agenda Item D.</p>
<p>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.</p>	<p>¶290.198 (Agenda Item D.2) states that the firm can implement “off-the shelf” accounting software that was not developed by the firm provided that the customization required to meet the client’s needs is clearly insignificant.</p>
Partner Remuneration	
<p>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.</p>	<p>ISQC1 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.</p> <p>The Task Force proposes (Agenda Item D.2 ¶290.229) that a key audit partner should not be evaluated on or compensated for the selling of non-assurance services.</p>