

Principles/Rules

Background

The Explanatory Memorandum to the Exposure Draft notes that the IESBA held a public forum in October 2005 to solicit input on which parts of Section 290 should be revised. The memorandum notes that forum participants, which included regulators, standard setters, leaders of accountancy organizations and members of the profession, supported the principles-based approach in the Code and suggested ways in which it might be clarified or augmented to provide auditors with clearer guidance in addressing independence issues.

The memorandum also notes that the IESBA considered the input received from the forum and benchmarked the existing Section 290 to the independence requirements in a number of jurisdictions to identify matters to be reconsidered.

The Exposure Draft maintains the principles-based approach such that if the particular circumstances would create a threat that is so significant no safeguard could reduce the threat to an acceptable level the activity, relationship or interest creating the threat must be avoided.

Discussion

Comments Received

34 respondents commented on the issue of a principles-based approach as opposed to a rules based approach. The respondents expressed concern that the exposure draft seems to be moving away from a principles based approach. Illustrative comments are:

- Although the draft claims that revised sections are based on a threats and safeguards approach the sections nevertheless contain a large number of proscriptions such that in practice they reflect a move towards a rules-based approach;
- For a principles-based approach to be robust, it should not be undermined by the proliferation of detailed underlying rules...the examples should not become proscriptive rules; the aim should be to deter auditors from “tick-box” compliance with the form of the requirement rather than the substance;
- Additional prohibitions should only be introduced if it is clear that there are significant threats and that public confidence in audit and assurance engagements is adversely affected by activities carried out in line with existing requirements;
- Whilst we acknowledge that a purely principles-based approach is unlikely to be sufficient, we are concerned with the increase in the number of restrictions. Additionally we are concerned that costs associated with certain aspects of the standards as proposed may outweigh the intended benefits.

Some of the respondents who expressed concern that the revisions were moving towards a rules-based approach expressed concern with some of the specific requirements – in particular the proposals partner rotation, on valuations for SPIES, the cooling-off requirement and the requirements on taxation services.

Analysis

Given the existence of a general concern but an absence, in the large part, of any specific amendments to address the concern, the Board considered the additional restrictions which were proposed in the Exposure Draft.

290 Para Ref	Description	Existing		Proposed		Additional Requirement?
		Non listed	Listed	Non SPIE	SPIE	
103	Member of audit team, immediate family member or firm should not have a direct financial interest or a material indirect financial interest in the audit client	√	√	√	√	N
105	Member of audit team, immediate family member or firm should not have a financial interest in an entity that has a controlling interest in the audit client if the client is material to the entity	√	√	√	√	Expanded to team members and immediate family
107	Partners in the office in which engagement partner practices in connection with the audit and immediate family members should not have a financial interest in the audit client.	√	√	√	√	N
109	Partners and managerial employees (and immediate family members) who provide non-audit services and whose involvement is not clearly insignificant should not have a direct financial interest or indirect financial interest in an audit client.	√	√	√	√	N
111	Firm, member of team, or immediate family member should not have a financial interest in an entity if the audit client or one or more of its directors, officers or controlling owners has a financial interest in that entity and the interest is material to either party and the audit client can exercise significant influence over the other entity.	√	√	√	√	N
112	Firm, member of audit team or immediate family should not hold a direct financial interest or a material indirect financial interest in an audit client as trustee unless certain conditions are met.	√	√	√	√	Expanded to immediate family members
116	Firm or member of the audit team should not have a loan or guarantee of a loan from an audit client that is a bank or similar institution if it is not made under normal lending procedures, terms and conditions.	√	√	√	√	N

		Existing		Proposed		Additional Requirement?
290 Para Ref	Description	Non listed	Listed	Non SPIE	SPIE	
119	Firm, member of audit team or immediate family should not make a loan to or guarantee the loan of an audit client.	√	√	√	√	Expanded to immediate family members
121	A firm or member of the audit team, should not have a close business relationship with the audit client or its management unless the financial interest is immaterial and the relationship is clearly insignificant.	√	√	√	√	N
125	Members of audit team should not have an immediate family member who is a director or officer of the audit client or an employee in a position to exert significant influence over the preparation of the accounting records or financial statements.	√	√	√	√	N
135	Key audit partner should not join a SPIE audit client in a position to exert significant influence over the preparation of the entity's accounting records or its financial statements or as a director or officer of the entity until a defined period of time has passed.				√	Y
136	The firm's Senior or Managing Partner should not join a SPIE audit client in a position to exert significant influence over the preparation of the entity's accounting records or its financial statements or as a director or officer of the entity until a defined period of time has passed.				√	Y
138	Staff may only be loaned to the audit client only if the assistance is for a short period of time and the personnel will not be involved in performing non-assurance services that would not be permitted under this section or in performing management functions.			√	√	Y
140	A member of the audit team should not have been, during the period covered by the audit report, a director or officer of the client or an employee in a position to exert significant influence over the preparation of the accounting records or financial statements	√	√	√	√	N

		Existing		Proposed		Additional Requirement?
290 Para Ref	Description	Non listed	Listed	Non SPIE	SPIE	
142	A partner or employee of the firm should not serve as a director or officer of an audit client.	√	√	√	√	N
144	A partner or employee of the firm should only serve as Company Secretary of an audit client when the practice is specifically permitted under local law, professional rules or practice and the duties and functions are limited to those of a routine and administrative nature and management makes all relevant decisions.	√	√	√	√	N
147	An individual should not be a key audit partner for more than seven years and should not return to the engagement team or be key audit partner until two years have elapsed		√		√	Expanded from engagement partner and EQCR to all key partners
158	A firm that provides professional services to an audit client should not perform management functions			√	√	Y
166	Except in emergency situations a firm should not provide to a SPIE audit client bookkeeping services, including payroll services, or prepare financial statements or financial information which forms the basis of the financial statements.		√		√	N
171	A firm should not provide a valuation service that has a material effect on the f/s and involves a significant degree of subjectivity	√	√	√		N
173	A firm should not provide a valuation service that has a material effect on the financial statements.				√	Y
178	A firm should not prepare tax calculations of current and deferred tax liabilities (or assets) for a SPIE audit client for the primary purpose of preparing accounting entries that are material to the f/s.				√	Y

		Existing		Proposed		Additional Requirement?
290 Para Ref	Description	Non listed	Listed	Non SPIE	SPIE	
182	The firm should not provide tax advice to an audit client where the effectiveness of the tax advice depends on a particular accounting treatment or presentation in the financial statements and there is reasonable doubt as to the appropriateness of the related accounting treatment or presentation and the outcome or consequences of the tax advice will have a material effect on the f/s.			√	√	Y
184	A firm should not act as an advocate for an audit client before a public tribunal or court in the resolution of a tax matter when the amounts involved are material to the financial statements.			√	√	Y
190	A firm should not provide any internal audit services to an audit client unless specified safeguards are applied.	√	√	√	√	N
197	A firm should not provide services involving the design or implementation of IT systems that form a significant part of the accounting systems of a SPIE audit client or generate information that is significant to the SPIE audit client's f/s.				√	Y
203	The firm should not act for an audit client in resolving a dispute or litigation when the amounts involved are material to the f/s.	√	√	√	√	N
207	The firm should not provide the following services for a SPIE audit client with respect to a director or officer of the client or an employee in a position to exert significant influence over the preparation of the accounting records or f/s: Searching for or seeking out candidates for such positions and undertaking reference checks of prospective candidates for such positions.				√	Y

		Existing		Proposed		Additional Requirement?
290 Para Ref	Description	Non listed	Listed	Non SPIE	SPIE	
211	The firm should not provide corporate finance advice to an audit client where the effectiveness of the advice depends on a particular accounting treatment or presentation in the financial statements and there is reasonable doubt as to the appropriateness of the related accounting treatment or presentation and the outcome or consequences of the advice will have a material effect on the f/s.			√	√	Y
212	The firm should not provide the following services to and audit client: Promoting, dealing in or underwriting and audit client's shares.	√	√	√	√	N
218	A firm should not charge a contingent fee for a non-assurance engagement if the amount of the fee is contingent on the results of the audit engagement.	√	√	√	√	N
220	A key audit partner should not be evaluated on or compensated for selling non-assurance services to his or her audit client.			√	√	Y

The IESBA discussed the additional requirements contained in the Exposure Draft. The IESBA noted that while the exposure draft does contain some additional requirements four of the additions relate to expanding an existing requirement to cover an immediate family member and six of the new requirements relate only to audits of entities of significant public interest.

The IESBA noted that changes in the exposure draft included those to make the requirements more clear and direct. The change was made to address concern expressed by some that it was difficult to identify the restrictions.

The IESBA determined that the issue was best addressed when considering the comments on each specific topic to determine whether the proposals in the exposure draft do stem from the application of the principles-based approach.

IESBA Direction

The IESBA is of the view that there is no conflict between a principles-based approach and absolute restrictions or prohibitions, provided that such restrictions or prohibitions flow directly from the application of the principles. The IESBA concluded that the matter will be considered on an item by item basis as the IESBA discusses proposed changes to respond to comments received on exposure – consideration will be given to whether the individual proposals are consistent with the principles-based approach.

Action requested

CAG members are asked to consider the direction of the IESBA and provide feedback.