

Draft Minutes
International Ethics Standards Board for Accountants (ISEBA)
CONSULTATIVE ADVISORY GROUP (CAG)
Held on December 11th 2007

<i>Present</i> Richard Fleck (chair)	Financial Reporting Council
: Marc Pickeur	Basel Committee on Banking Supervision
Torben Haaning	Fédération des Experts Comptables Européens
Hilde Blomme	Fédération des Experts Comptables Européens
David Damant	IAASB Consultative Advisory Group and CFA Institute
Susan Koski-Grafer	International Organization of Securities Commissions
Patricia Sucher	International Organization of Securities Commissions
Filip Cassel	International Organization of Supreme Audit Institutions
Angela Chin	Institute of Internal Auditors
Greg Scates	Public Company Accountability Oversight Board (in-part by telephone)
John Hegarty	World Bank
Richard George	IESBA (chair)
Jean Rothbarth	IESBA Member
Jan Munro	IESBA Senior Technical Manager
<i>Regrets</i> Rebecca Todd McEnally	CFA Institute
Federico Diomeda	European Federation of Accountants and Auditors for SMEs
Gerald Edwards	Basel Committee on Banking Supervision
Vickson Ncube	Eastern Central and Southern African Federation of Accountants
Jean-Luc Peyret	European Federation of Financial Executives' Institutes
Georges Couvois	European Federation of Financial Executives' Institutes
John Carchrae	International Organization of Securities Commissions
Tomokazu Sekiguchi	International Organization of Securities Commissions

A. Opening Remarks

Mr. Fleck welcomed all participants to the additional meeting of the CAG. He welcomed Angela Chin from the Institute of Internal Auditors.

Mr. Fleck reported that the IESBA had revised its timetable for completion of the projects on Independence I, Independence II and Drafting Conventions. He indicated that the IESBA had discussed the content of the drafting conventions exposure draft and concluded that it was important to obtain comment on the implications of the drafting conventions project on the output of the Independence I and II projects. The IESBA had, therefore, revised the planned IESBA timetable as follows:

- Independence I – To be finalized January 2008
- Independence II – To be finalized April 2008
- Drafting Conventions – Exposure draft approval in April 2008. Exposure draft to include the output of Independence I and II with changes to reflect the drafting conventions.

Mr. Fleck reported that the April exposure draft will request comment on only the changes to reflect the implications of the drafting conventions project.

Ms. Koski-Grafer raised a question regarding the draft minutes from the September 2007 CAG meeting. She indicated that these minutes recorded that the CAG agreed with the following outcome of the discussion as to how future minutes would record the views of the CAG as either:

- The CAG is generally in agreement with the proposed IESBA course of action; or
- The CAG is generally in disagreement with the proposed IESBA course of action and provide the rationale for the disagreement; or
- The CAG has differing views on the proposed IESBA course of action. The differing views would be explained with the arguments that support each of the differing views.

Ms. Koski-Grafer indicated that she had consulted with colleagues who attended the September meeting. The colleagues recalled the discussion but did not recollect that the outcome of the discussion was as conclusively resolved as recorded in the minutes. She noted that it would be useful for the CAG to have a further discussion of what the CAG can reasonably do without overstating the point, given that the CAG has not been a decision making or consensus building body and more typically there would be individual CAG member views rather than a CAG view. She indicated that she had the impression that the issue was not fully resolved at the September meeting, and, therefore, she felt it was important for the CAG to have a focussed discussion on this area.

Mr. Fleck observed that it was important that CAG discussions were appropriately communicated to the IESBA. He indicated that, particularly for contentious issues, it was quite common for the IESBA to ask what the CAG thought about a particular issue. As discussed at the previous CAG meeting, his aim was to try and draw the views together,

where possible, because having a series of random comments from the CAG was not particularly helpful to the IESBA.

Mr. Damant noted that the IAASB CAG did not attempt to reach a consensus. Mr. Cassel noted that on a pragmatic basis he could appreciate the need for knowing if there is a consensus. However, someone reading the minutes might obtain an over simplified impression of the discussion at the meeting. Mr. Haaning noted that it was important that if a consensus was recorded everyone should agree with the conclusion and if someone did not agree with the conclusion they should have the opportunity to express their view.

As a separate matter, Ms. Koski-Grafer noted the minutes did not attribute comments to the particular CAG member who had raised the issue. She raised the question as to whether the minutes should contain an attribution (particularly as comments were attributed to other, non-CAG individuals).

It was agreed that the matter would be discussed further by CAG members either later in the executive session or at a subsequent CAG meeting.

B. Report from IESBA Chair

Mr. George noted that a Chair's report and draft minutes from the last IESBA meeting on October 24-26, 2007 in Toronto were included in the agenda materials. As reported by Mr. Fleck, the IESBA had revised its timetable with respect to the exposure draft reflecting the drafting implications of the Code.

He reported that the IESBA had also discussed the Strategic and Operational Plan and, in a conference call subsequent to the meeting, had unanimously approved the plan. He indicated that the Plan would be released after the PIOB had confirmed that due process had been followed in its development. Mr. Fleck noted that it was important that, at a future meeting, the CAG discuss the implications of the plan.

C. Independence I

Ms. Rothbarth, Independence Task Force Chair, reported that the Independence I Task Force had met immediately after the September CAG meeting to continue its discussion of revisions to respond to comments on exposure and to comments received from CAG members. At its October 2007 meeting, the IESBA had reviewed the first draft of a revised text. The Task Force would meet again, immediately after this CAG meeting, and that the IESBA planned to approve the final text at its January 2008 meeting.

Public Interest Entities

Ms. Rothbarth reported that, after considering all the comments received and the CAG comments, the IESBA is of the view that the definition of entities of significant public interest should be limited to listed entities and other entities that a regulator or legislation has designated to be an entity of significant public interest. In addition, Section 290 will contain an encouragement for firms and member bodies to consider whether other types of entities should be treated as entities of significant public interest for independence

purposes, thus subjecting the audit to the more stringent independence requirements contained in Section 290. The section would contain guidance on the factors that might be considered in making this determination. The IESBA is also of the view that, in light of the narrower definition, the reference to “significant” can be dropped.

Mr. Damant asked whether the IESBA had considered the International Accounting Standards definition in the development of the IESBA definition. Ms. Rothbarth confirmed that the Task Force and the IESBA had considered the definition.

Mr. Pickeur indicated that he was disappointed with the definition of public interest entities and was concerned that it would only mandate the additional requirements for the audit of listed entities. He also noted the minutes from the October 2007 IESBA meeting in Toronto recorded that this area was an extremely difficult issue. He stated that he did not agree that it was an extremely difficult issue and, as noted in the Basel response to the exposure draft, he disagreed with the conclusion that it was impracticable to develop a single definition of an entity of significant public interest that would have global application and be suitable in all jurisdictions. He noted that, as indicated in the response, the view of the Basel Committee on Banking Supervision was that public interest entities should always include regulated banks even when some of those regulated banks would not have a large and wide range of stakeholders. Since regulated banks accept money from the public and have a pivotal role in the economy (e.g. payments services and loans) these organizations should be considered entities of public interest.

Mr. Fleck questioned where the line was drawn if the definition was extended beyond listed entities to for example charities that accept money from the public. Some charities are large national organizations; others are very small and have only a local role.

Mr. Pickeur also noted that it was not clear from the definition as to which regulator would be covered by the definition (e.g. would it include the regulator of the auditor?).

Ms. Rothbarth noted that the definition would include any regulator that had the requisite authority (including any regulator of the auditor). With respect to the difficulty with a global definition, she indicated that, at the outset of the discussion, the Task Force had undertaken a benchmarking exercise to examine how different jurisdictions had defined public interest entities. Many jurisdictions have adopted a size test as an element of the definition, and this size test varies significantly from jurisdiction to jurisdiction.

Mr. Pickeur noted that the definition includes “entities for which a regulator or legislation requires in the audit of those entities compliance with the same independence requirements as those that apply to listed entities.” He thought that regulation might be less specific than the draft contemplated (and would often be silent with respect to independence) and, therefore, this part of the definition might be ineffective to capture any additional entities.

Ms. Koski-Grafer asked about the consequences once a firm had determined to treat an entity as a public interest entity and whether there would be auditing practice

implications as well as independence implications. Ms. Rothbarth responded that a firm may decide to treat a certain class of client as a public interest entity and, once so designated, the more stringent independence requirements would apply and, under auditing standards, an engagement quality control review would be called for.

Mr. Haaning indicated that there may be a problem with dropping the term “significant” in that it might be more problematic for firms to now designate an entity as a public interest entity and the firms might designate too many firms as public interest entities. Mr. Fleck responded that the deletion of the word “significant” was not intended to change the meaning rather it was a way of simplifying the drafting. As to the matter of over application of the concept of public interest entities, he noted that the guidance also encouraged member bodies to make the designation.

Mr. Fleck summed up the discussion and asked the Task Force to reconsider the issue of regulated banks and see if more guidance could be given on the factors member bodies should take account of when determining whether additional entities should be treated as public interest entities.

Mr. Cassel also asked that the Task Force consider whether it would be clearer to say “any” regulator rather than “a” regulator.

Ms. Koski-Grafer expressed a concern regarding the firm making a designation that an entity should be treated as a public interest entity rather than the regulator determining this. She noted that this was not problematic for independence requirements but questioned the implications on auditing requirements.

Partner Rotation

Ms. Rothbarth reported that, after considering all the comments received and the CAG comments, the IESBA is of the view that section 290 should require partner rotation except when the firm has few people with necessary knowledge and experience to serve as key audit partner and the independent regulator in the jurisdiction has provided an exemption in such circumstances and has specified alternative safeguards.

Mr. Haaning asked whether the section will specify the types of safeguards required in such circumstances. Ms. Rothbarth stated that the IESBA is of the view that it would be inappropriate for the Code to specify the safeguards that should be applied, given that it may vary from jurisdiction to jurisdiction.

Ms. Rothbarth reported that the IESBA was of the view that after an individual has been a key audit partner for seven years, that individual should not participate in the audit of the entity, or be in a position to directly influence the outcome of the engagement, through providing quality control for the engagement or providing consultation regarding technical or industry-specific issues, transactions or events.

Mr. Fleck noted that, as drafted, this seemed to relate to technical partners rather than individuals in the “chain of command.” Ms. Rothbarth indicated that it was important that

the drafting did not preclude a former key audit partner from becoming the chief executive of the firm. Mr. Fleck responded that the drafting could accommodate this. Ms. Koski-Grafer expressed support for the comment raised by Mr. Fleck, and noted that she was always looking for places in the Code where the principles could be emphasized. Mr. Cassel also expressed support for the comment.

Ms. Blomme indicated that she had always read the requirement on a one on one basis and had not thought that it would incorporate the “chain of command”. She questioned whether, for example, if a former key audit partner became the risk management partner this would be problematic.

Mr. Fleck summed up the discussion and asked the Task Force to consider and explore the issues that had been raised by CAG members.

Key Audit Partner Definition

Ms. Rothbarth reported that, after considering all the comments received and the CAG comments, the IESBA is of the view that the definition of key engagement partner should be:

“The engagement partner, the individual responsible for the engagement quality control review, and other audit partners, if any, on the engagement team who make key decisions or judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion. Depending on the circumstances and the role of the individuals on the audit, other “audit partners” may include, for example, audit partners responsible for significant subsidiaries or divisions.”

Mr. Fleck indicated that this was a difficult area and noted that the definition was different from the EU definition. Ms. Rothbarth responded that the IESBA had carefully considered the EU definition and was of the view that for a global Code it might have too wide an application.

Ms. Koski-Grafer stated that she did not object to the proposed IESBA definition for a global Code. Mr. Fleck indicated that clearly the matter would have implications for convergence. Ms. Koski-Grafer noted that it was an interesting question as to whether it would ever be possible for the Code to serve as the global standard in the same way as some as proposing that International Auditing Standards be recognized. She noted that it would be very useful to have a discussion of the prospects for ethics and independence standards convergence at a future CAG meeting.

Mr. Hegarty asked about the thought process in determining which “subsidiary” partners were key audit partners – for example was there a presumption that all such partners would be key audit partners? If the conclusion was that these partners do not make key decisions or judgments on significant matters with respect to the financial statements would this matter be documented? Ms. Rothbarth responded that, in her view, there would likely be a presumption but it would depend upon the circumstances. She thought

that the general documentation requirement would apply and should be sufficient to address Mr. Hegarty's point.

Mr. Fleck summed up the discussion and asked the Task Force to consider whether there needed to be a specific documentation requirement or whether this would be covered by the general documentation requirement.

Engagement Team

Ms. Rothbarth reported that IEBSA was proposing changing the definition on engagement team so that the definitions in the ISAs and the Code could be aligned. The IESBA was, therefore, proposing the following definition:

“All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on the engagement. This excludes auditor’s external experts engaged by the firm or a network firm.”

Ms. Blomme noted that the ISA 620 *Using the Work of an Auditor’s Expert* is currently out for exposure. She indicated that the Fédération des Experts Comptables Européens would be carefully considering the exposure draft and would also be considering the alignment of the definitions. Ms. Rothbarth noted that the ISA 620 exposure draft contained a footnote flagging the intent to align the two definitions and, if ISA was not final when the Code was to be released, it was expected that a similar note would be contained in the Code.

Mr. Hegarty asked whether there was an intended difference between “performing the engagement” and “perform assurance procedures”. Ms. Rothbarth indicated that part of the definition was important to the IAASB.

Mr. Fleck summed up the discussion and noted CAG members’ agreement that the definitions should be aligned. He cautioned that it was important that the aligned definition achieved its intended effect (see below for further comments on the drafting of the definition).

Non-audit Services

Ms. Rothbarth provided an overview of significant matters with respect to changes related to the non-assurance services provisions. She noted that she would only touch on significant matters, but would be pleased to take any comments members of the CAG might have on any of the paragraphs.

Valuation Services

Ms. Rothbarth noted that the exposure draft provided additional guidance on the meaning of significant subjectivity and proposed that a firm should not perform a valuation service for an audit client that is a public interest entity if the valuation would have a material effect on the financial statements.

Mr. Pickeur noted that this additional provision was important because of the increasing use of fair values.

Preparation of Tax Calculations

Ms. Rothbarth noted that the IESBA proposed that Section 290 would indicate that preparing tax calculations for purpose of preparation of accounting entries may create a threat and, if the threat was not clearly insignificant, safeguards should be applied. For public interest entities, a firm should not perform calculations for the purpose of preparing accounting entries that are material to the financial statements.

Ms. Koski-Grafer indicated that IOSCO had not yet had a chance to discuss the latest changes to the proposals. She indicated that there was not a mechanism for CAG members who have responded to an exposure draft to track the changes that have been made to the document. She indicated she felt that there was a vacuum in the process that should be filled.

Mr. Haaning commented that there are a lot of small entities that might not have the expertise to prepare the tax calculations. He noted that in Denmark, for example, the tax authorities have indicated that if the auditors of these entities do not prepare the tax calculations, the tax authorities will select the calculations for special scrutiny. Ms. Rothbarth noted that because the restriction related to public interest entities, whether the auditors are able to prepare the tax calculations would depend upon whether the entity was designated to be a public interest entity.

Mr. Scates noted that the bookkeeping provisions for public interest entities did not have a materiality threshold. Ms. Rothbarth agreed that was the case with the general provision but noted that section 290 only permitted accounting and bookkeeping services of a routine or mechanical nature for divisions or related entities that are not material.

Tax Planning and Other Advisory Services

Ms. Rothbarth noted that the IESBA proposed that Section 290 would indicate that a self-review threat may be created when advice will affect matters to be reflected in the financial statements. In addition, the firm cannot provide advice if the effectiveness of advice depends on a particular accounting treatment and there is reasonable doubt as to appropriateness of the treatment and whether the outcome will be material to the financial statements.

Mr. Pickeur questioned whether it was proposed that section 290 would contain guidance on providing tax advice that was particularly aggressive. Ms. Rothbarth responded that there was not specific guidance on this area but noted that such circumstances would be addressed by the provisions under Section 110 of the Code addressing integrity. Ms. Koski-Grafer also noted that one of the factors to be considered in evaluating the significance of any threat to independence was whether the advice is supported by tax law, regulation, other precedent or established practice.

Tax Valuations

Ms. Rothbarth reported that there had been some comment on exposure that the exposure draft did not address valuations that are performed solely for tax purposes. She noted that the existing Code states that performing a valuation service for an audit client for the tax purposes does not generally create a significant threat to independence, because such valuations are generally subject to external review, for example by a tax authority. She indicated that the IESBA had debated this matter at the meeting in Toronto and had asked the Task Force to consider the issue and develop a position.

Ms. Rothbarth reported that the Task Force had developed a tentative position that would be considered again, together with any input from members of the CAG, at its next meeting and a proposal would be presented to the IESBA at its meeting in January. She noted that the Task Force was of the view that valuations performed for tax purposes generally do not threaten independence if the results of valuation are not directly reflected in the financial statements and provided the effect is immaterial or the valuation is subject to external review. If the effect of the valuation is material and is not subject to external review, the significance of the threat should be evaluated and safeguards applied as necessary to eliminate the threat or reduce it to an acceptable level. For those tax valuations that are directly reflected in the financial statements, the provisions in the valuations section of 290 would apply.

Mr. Pickeur noted that the key word was “directly” because most tax valuations would indirectly affect the financial statements.

Mr. Fleck noted that he found this area quite difficult because of the splitting of tax valuations from other valuations. He noted that the approach was useful in assisting with the consideration of the financial statement effect.

Ms. Rothbarth indicated that, initially, there had been differing views as to whether tax valuations should be analyzed under the valuations provisions or the tax provisions. She noted that the Task Force was of the view that the proposed approach recognized that valuations are often performed as part of the tax compliance work.

Ms. Sucher indicated that while she had not had the opportunity to discuss the proposal with IOSCO, the proposed approach did seem to be possibly overly complex and it might be preferable to start with the statement that when the valuation directly affects the financial statements, the provisions of the valuation section should apply.

Mr. Pickeur noted that while, historically, auditors were involved in providing taxation services to their clients he was not convinced that such services should be provided.

Ms. Blomme noted that addressing valuations for tax purposes appears to be helpful guidance and clarification whereby the language refinements remain to be seen.

Assistance in Tax Disputes

Ms. Rothbarth noted that the IESBA proposed that Section 290 would indicate that a threat may be created when firm represents an audit client in resolution of tax dispute when tax authorities have notified client that they rejected the taxpayer's argument and the dispute is being referred to a tax authority. The section also provides that the firm cannot act as an advocate for an audit client before a public tribunal or court in a dispute where the amounts are material.

Mr. Haaning questioned what was meant by a “public tribunal”. Ms. Rothbarth responded that the IESBA, and the proposed drafting, recognized that it will vary from jurisdiction to jurisdiction.

Mr. Pickeur questioned whether it would be possible for an auditor to appear before a tribunal on behalf of its audit client. Ms. Rothbarth responded that it would depend upon the nature of the tribunal.

IT Systems Services

Ms. Rothbarth noted that the exposure draft had proposed that an auditor should not provide IT systems design *and* implementation services to an audit client that was not a public interest entity and for public interest entities the auditor should provide neither design *nor* implementation services.

Members of the CAG made no comment on the proposed approach.

Cooling off period

Ms. Rothbarth noted that the IESBA was of the view that there should be a mandatory “cooling off period” if a key audit partner or the firm CEO joins client as a director or officer, or in position to exert significant influence over the financial statements. The IESBA was of the view that a former key audit partner should not join an audit client in such a position unless the client has issued audited financial statements for a period of not less than twelve months for which the partner was not a member of the audit team. She noted that, in the case of the firm’s CEO, the period was twelve months.

Members of the CAG made no comment on the proposed approach.

Next Steps

Ms. Rothbarth reported that the IESBA planned to finalize the revisions for the project at its January meeting. This output would then be modified to reflect the changes resulting from the drafting conventions and, as previously mentioned, exposed for comment only on the drafting conventions. Ms. Koski-Grafer noted that the IAASB clarity project had prompted much discussion and, therefore, it might not be possible to ignore comments that are not strictly related to the implications of the drafting conventions project. She noted that there needed to be a balance between providing flexibility to look at all comments and ensuring that the Code does get finalized so that people can start implementing the new independence requirements. Mr. Fleck responded that inevitably some respondents will comment on matters that do not relate to the application of the

drafting conventions but it is important, as noted by Ms. Koski-Grafer, to provide some flexibility to reconsider an issue if it is clear that it is not well understood.

Ms. Rothbarth reported that the IESBA would be discussing the proposed effective date at its January meeting and this would be discussed the CAG at its meeting in March. It is intended that the proposed effective date will be exposed for comment.

Walk through the document

The CAG considered the document section by section and provided the following comments:

Mr. Damant asked whether the section provided guidance on the magnitude of non-assurance fees. Mr. Fleck responded that the position taken in the Code was that, provided the firm complied with the non-assurance services sections, the fact that there were considerable fees for non-assurance services was not, in itself, an issue. Mr. Damant expressed the view that it was important that the Code recognize the perception problem. Ms. Sucher agreed that the Code should address the issue because it was clear that if the quantum of non-assurance fees was large in relation to the audit fee, at a minimum, there was a perception that there was a threat. Mr. Fleck stressed the importance of seeing this in context because if there was a significant takeover, for example, this could skew the relationship. Ms. Rothbarth noted that this issue was addressed in the introduction to the Section.

Ms. Koski-Grafer noted that the clarity of the section would be improved if the last sentence of 290.500 (“The modifications should not, however, be applied in the case of an audit of historical financial information required by law or regulation.”) was repeated in paragraph 290.1.

Ms. Blomme questioned whether the proposed change in paragraph 290.9 changed the meaning of the paragraph (“a firm should identify and evaluate any threats to independence and consider the availability of appropriate safeguards to eliminate any threat or reduce it to an acceptable level”).

Ms. Koski-Grafer noted that paragraph 290.6 was expressed in the negative and questioned whether it could be stated in the positive.

Ms. Koski-Grafer questioned the meaning of the last sentence of 290.12 (“The independence requirements in this section that apply to a network firm apply to any entity that meets the definition of a network firm irrespective of whether the entity itself meets the definition of a firm.”) Ms. Munro noted that this sentence was unchanged and was included in the Code to emphasize that networks may include not only firms of professional accountants but also other entities.

Ms. Koski-Grafer noted that paragraph 290.31 addressed the provision of prohibited non-assurance services provided to the audit client during or after the period covered by the financial statements. She questioned whether the Task Force had considered whether

there might be other safeguards or remedies in addition to those listed in the bulleted items, for example in the case of a firm engaged to do an audit and finding that prohibited services had been provided, then having a discussion with the regulator and coming to resolution as to whether there might be an appropriate workout action to take. She noted that this could be a practical solution in some situations and was an action that took place in practice on occasion.

Ms. Blomme noted that paragraph 290.113 was a difficult read and it might be clearer if the (a), (b) convention was used.

Ms. Sucher questioned whether the linkage from paragraph 290.131 to Internal Standards on Quality Control was sufficiently clear.

Ms. Sucher noted that the guidance in paragraph 169 looked close to preparing financial statements – in particular the reference to converting financial statements from one financial reporting framework to another. Ms. Rothbarth noted that the paragraph referred to providing technical assistance. Ms. Sucher stated that there was a spectrum and at some point along the spectrum assistance can become “doing”. She also noted that some of the disclosures in IFRS are quite substantial. Mr. Fleck questioned whether it would be helpful to refer to converting *existing* financial statements. He indicated that it was important that the assistance with the conversion does not include the judgment element because this is a management responsibility. Mr. Fleck asked whether the concern was only with respect to public interest entities noting that the challenge of converting to IFRS might be quite substantial for small entities. Ms. Koski-Grafer noted that the financial statements are the responsibility of management and questioned whether it might be preferable to have a “carve-out” for small entities.

Ms. Blomme questioned why the reference to review engagements had been dropped in paragraphs 290.500 addressing restricted use engagements. Ms. Rothbarth noted that there were no reporting standards for such engagements. Members of the CAG discussed whether, in practice, restricted use review engagements existed.

Mr. Fleck contrasted the language in the definitions being used to describe the definition of the “engagement team” and in “external expert”. One definition uses the phrase “engaged, not employed” and the other definition uses on the word “engaged”. He indicated that it would be helpful to have a consistent use of the term.

Ms. Rothbarth thanked members of the CAG for their input and indicated that the Task Force would carefully consider the comments at the Task Force meeting the following day.

D. Implications of the IAASB Clarity Project on the Code

Mr. George, IESBA chair, presented the agenda item noting that the purpose of the project was to determine the implications on the Code of the IAASB clarity conventions, develop other changes to improve the clarity of the Code and remove inconsistencies and it was not intended to change substance or create new requirements.

With respect to the IAASB Clarity conventions, he noted that the IESBA was of the view that the clarity of the Code would be improved if the word “shall” were to be used to designate a requirement. The use of “shall” in the Code will achieve consistency with the IAASB drafting – users of the Code who perform assurance engagements will be knowledgeable of the ISAs and using different terms to denote a requirement would be confusing. It will also have advantages from a compliance and translation perspective.

Mr. George indicated that the IESBA is of the view that, because the structure of the Code and the structure of the ISAs are very different, separately presenting the objective to be achieved, the requirements designed to achieve that objective, and the application material, as in the ISAs, would not improve the clarity of the Code. As currently drafted, Part A of the Code establishes the fundamental principles of professional ethics for professional accountants and provides a conceptual framework for applying those principles. Parts B and C of the Code illustrate how the conceptual framework is to be applied in specific situations. In all cases, the objective to be achieved, as outlined in the conceptual framework, is to identify threats to compliance with the fundamental principles and apply safeguards to eliminate the threats or reduce them to an acceptable level.

Mr. George reported that the IESBA had discussed a proposed exposure draft at its meeting in October 2007 and had concluded that it was important to expose the impact of the drafting conventions on the output of the Independence I and II projects. The IESBA had, therefore, revised its timetable and was now planning on approving an exposure draft at its April 2008 meeting. He indicated that, in addition to the proposals addressing the “clearly insignificant” threshold, the IESBA had discussed the use of the word “shall” and the use of the words “consider”, “evaluate” and “determine”.

The IESBA also had a discussion on how the Code describes a threat. The IESBA recognized the Code is not always clear in how it describes threats. For example in some cases it states that a particular relationship *may* create a threat and then it states that *the* significance of the threat should be evaluated – if a matter *may* create a threat it would be more logical to then require the significance of *any* threat to be evaluated. The IESBA had also discussed the fact that in some instances the Code states that a matter may create a threat but in the view of some IESBA members the matter did create a threat and the statement that a threat may be created weakens the Code. Other IESBA members were of the view that it was important to state that a threat may be created because this requires the professional accountant to think further and determine whether a threat is created. It was noted that the construction that a matter may create a threat had been raised by IOSCO in responses to exposure drafts. Mr. George reported that the IESBA had asked the Task Force to consider these matters and develop a position paper for discussion at its January meeting.

Mr. George reported that the IESBA was proposing eliminating the use of the term “clearly insignificant” and clarifying the documentation requirement, without reducing the accountant’s thought process in addressing threats. With the elimination of the term

“clearly insignificant” the professional accountant would be required to identify and evaluate the significance of threats and, when necessary, to apply safeguards to eliminate the threats or reduce them to an acceptable level. The IESBA concluded that with the deletion of the term “clearly insignificant” it was appropriate to provide guidance on what was intended by an “acceptable level”. The IESBA is of the view that it would be appropriate for the Code to define this term and it has developed the following definition:

“An acceptable level is a level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that compliance with the fundamental principles is not compromised.”

Mr. George reported that the IESBA was of the view that the following documentation requirement was appropriate for the Code:

“While documentation is not, in itself, a determinant of whether a firm is independent international auditing standards do require documentation of (i) conclusions regarding compliance with independence requirements and (ii) any relevant discussions that support those conclusions. When threats to independence are identified that require the application of safeguards, the documentation shall describe the nature of those threats and the safeguards applied to eliminate the threats or reduce them to an acceptable level.”

Mr. Hegarty noted that if a threat is identified but the auditor concludes that no safeguards are necessary this should be documented. Mr. George indicated that the IESBA is of the view that documentation is not a determinant of independence and is rather a matter for auditing standards and these standards require documentation of the conclusions regarding compliance with independence requirements and any relevant discussions that support those conclusions. Mr. Hegarty indicated that he had read the second sentence in the requirement as an over-ride of the first and that it was not clear that both sentences applied in the cases where safeguards were applied.

Mr. Fleck noted that there would be many situations where a threat was identified but safeguards were not necessary. It was, therefore, important to strike the appropriate balance in documentation.

Mr. Haaning questioned whether it would be clearer if the second sentence stated “In addition, the documentation shall describe.”

Ms. Sucher indicated that she welcomed the proposed approach and suggested that the exposure draft contain a table which shows each use of “consider”, “evaluate” and “determine”. In addition it would be useful if the exposure draft provided a rationale for the IESBA’s determination as to why the changes were made i.e. why “should consider” has become “should evaluate” or “should determine”. Such an approach would help respondents to understand why the IESBA had chosen a particular verb.

Mr. Damant noted that the IAASB uses a plain language editor. Ms. Munro indicated that the IESBA uses the same plain language editor.

Ms. Sucher noted that, regarding the issue of “may create”, the IOSCO perception is that in many instances in the Code the matters noted do create a threat to independence. Mr. Fleck indicated that in the IESBA discussion at the October meeting it had been agreed that it was important to have a structured approach to thinking about threats and that this approach should be clearly articulated in the Code.

Ms. Blomme stated that she was unsure about the impact of the proposed changes to clarify that the examples contained in the Code were mandatory. Mr. George responded that the text of the proposals would be discussed by the CAG at its March meeting.

E. Independence II

Mr. Fleck indicated that the purpose of the agenda item was to provide the CAG with an overview of the comments received on the exposure of the proposed changes to internal audit, relative size of fees and contingent fees.

Internal Audit Services

Mr. Fleck indicated that the exposure draft had proposed that a self-review threat may be created when a firm provides internal audit services to an audit client. The exposure draft also indicated that the firm should not perform management functions and should only provide assistance to an audit client’s internal audit function if specified conditions were in place.

He indicated that the majority of respondents either implicitly or explicitly supported the position taken though seven respondents were not supportive. These respondents either expressed the view that a firm should not provide internal audit services to any audit client, a firm should not provide internal audit services to audit clients that are entities of public interest or a firm should not provide internal audit services if the auditor is going to place significant reliance on the internal audit work.

Mr. Pickeur indicated that there was a problem if the audit client was a public interest entity, such as a bank, where the internal audit work would be relied on in the course of auditing the client’s financial statements. He noted that several jurisdictions had an absolute prohibition on providing such services to a regulated bank and several prohibited complete outsourcing of internal audit by a regulated bank.

Mr. Fleck asked CAG members who felt that reliance was an issue to explain why they thought this was a problem. Mr. Pickeur indicated that the problem was compounded by the lack of a definition of internal audit and indicated that the Basel response letter to the exposure draft had suggested that it would be helpful if the section would start with a definition of internal audit before elaborating on the wide range of activities that internal audit functions comprise. He noted that a useful, and widely used, definition of internal audit is the definition provided by the Institute of Internal Auditors.

Ms. Koski-Grafer stated that there is a wide range of activities that could be captured under the definition of internal audit services. She noted that there was a difference between internal audit services that intersect with financial reporting, and operational

internal audit services. She indicated that it would be useful if the Task Force developed principles and rationale for those internal audit services that could be provided, and those which should be restricted.

Ms. Sucher noted that, in her view, reliance was not the only issue. Mr. Pickeur agreed, noting that all large banks should have their own internal audit department and should not outsource these activities. Ms. Koski-Grafer stated that it might be helpful in the non-audit service section to state that if there are mandatory requirements (for example if a particular jurisdiction prohibited providing internal audit services to a public interest audit client) these should be complied with.

Fees Relative Size

Mr. Fleck indicated that the exposure draft had proposed that if total fees from a public interest audit client were greater than 15% of the total fees of the firm disclosure should be made to those charged with governance, and a professional accountant from outside the firm should conduct either a post-issuance or a pre-issuance review. In subsequent years, in determining which of these safeguards to apply consideration should be given to the relative size of fee but at a minimum a post issuance review should be conducted once every three years.

He indicated that respondents to the exposure draft were mixed in their views as to whether a bright-line test was appropriate. Some were of the view that it was a reasonable threshold and a bright-line was necessary for clarity and consistent application. Others were of the view that a bright-line was not consistent with a conceptual framework and also noted that the proposals might have a disproportionate impact on smaller firms and on audit firm concentration.

Mr. Fleck noted that without a bright-line test it was extremely difficult to have confidence that appropriate action should be taken. He further noted that the bright-line did not represent a prohibition rather it represented the threshold at which a specific safeguard was necessary.

Mr. Hegarty questioned why there was no provision for action by an independent regulator. Ms. Blomme agreed with the question and wondered whether review by an independent regulator would be an appropriate safeguard.

Ms. Koski-Grafer noted that the economic dependence proposal that was contained in the ED was only one of many types of economic dependence conditions that could arise and as stated could have a disproportionate impact on smaller firms. She noted that if a bright line was retained, it might be preferable for the threshold to be used as a signal that it was necessary to have a discussion with a regulator to determine what steps are appropriate to address the threat, rather than as a trigger for a specific remedial action. She also indicated that relative size of fees was not only relevant with respect to the firm, it was relevant to economic dependence that could occur at an audit firm office level and with respect to individual partners, and suggested that it would be useful for the Board to explore developing broad principles for addressing such issues.

Contingent Fees

Mr. Fleck indicated that the exposure draft had proposed that a firm should not perform a non-assurance service for an audit client if the amount of the fee is material to the firm, or if the fee is dependent upon the outcome of a future or contemporary audit judgment related to a material amount in the financial statements.

Ms. Koski-Grafer noted that her personal view was that, while the threshold was materiality, there can still be important issues when the amount is not material.

F. Closing

Mr. Fleck thanked all members of the CAG for their participation and closed the meeting.

G. Future Meeting Dates

March 5, 2008 (Basel, Switzerland) extended to March 6, 2008
September 3, 2008 (Toronto, Canada)