

Draft Minutes
International Ethics Standards Board for Accountants (ISEBA)
CONSULTATIVE ADVISORY GROUP (CAG)
Held on March 5, 2008

<i>Present</i>	Richard Fleck (chair)	Financial Reporting Council
:	Marc Pickeur	Basel Committee on Banking Supervision
	Rebecca Todd McEnally	CFA Institute
	Federico Diomeda	European Federation of Accountants and Auditors for SMEs
	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
	Tom Ray	Public Company Accounting Oversight Board
	Simon Bradbury	World Bank
	John Hegarty	World Bank
	Richard George	IESBA (chair)
	Ken Dakdduk	IESBA Member
	David Winetroub	IESBA Member
	Jan Munro	IESBA Senior Technical Manager
	Jim Sylph	IFAC Executive Director, Professional Standards
	Sir Bryan Nicholson	PIOB
<i>Regrets</i>	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
	Greg Scates	Public Company Accountability Oversight Board

A. Opening Remarks

Mr. Fleck welcomed all participants to the CAG meeting. He welcomed Tom Ray from the Public Company Accounting Oversight Board and Simon Bradbury from the World Bank. He also welcomed PIOB observer, Sir Bryan Nicholson.

The minutes from the December 11, 2007 meeting were approved as presented. Ms. Koski-Grafer noted that the minutes were well prepared and had been circulated very quickly after the meeting.

B. Report from IESBA Chair

Mr. George noted the importance of the timing of this meeting because of the need to provide input on the IESBA projects on Independence II and Drafting Conventions.

He reported that the most significant activity at the IESBA meeting held in January 2008 was the unanimous approval of the changes to independence requirements in the Code resulting from the December 2006 exposure draft. He thanked Mr. Fleck and Mr. Pickeur for their assistance during the meeting regarding the definition of public interest entities. He indicated that the IESBA had approved the following definition of a public interest entity:

- “(a) A listed entity; and
- (b) An entity (a) defined by regulation or legislation as a public interest entity or (b) for which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation may be promulgated by any regulator, including an audit regulator.”

Ms. Todd McEnally questioned what was meant by a listed entity. Ms. Munro indicated that this term is defined in the Code as:

“An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.”

Mr. Fleck noted that the IESBA was of the view that, for a global Code, it was not appropriate to automatically define all banks and other deposit taking institutions as public interest entities. In some jurisdictions, such entities might be quite small – for example some credit unions. He noted that the IESBA had, therefore, added a piece in the definition to leave the door open for regulation or legislation to designate an entity as a public interest entity.

Mr. Pickeur indicated that he was appreciative of the improvement to the definition of public interest entities. He noted that while there will be different ways that such entities are regulated, the drafting will encourage an examination of the issue. Ms. Koski-Grafer echoed Mr. Pickeur’s comments.

C. Independence II

Mr. Winetroub, Independence II Task Force Chair, reported that the comment period on this project had ended on October 15, 2007. The IESBA considered the comments received and a first draft of changes in response to the comments at its meeting in January 2008. Subsequent to the IESBA meeting, the Task Force met to consider the input of the IESBA and, in places had made revisions to address the input. The CAG agenda papers, therefore, contain the latest direction of the Task Force, some of which had not yet been discussed by the IESBA. He reported that the Task Force would consider any input from the CAG and the IESBA planned to approve the proposed changes at its April 2008 meeting.

Internal Audit

Mr. Winetroub noted that the exposure draft proposed amending the guidance of internal audit services to clarify the wide range of services that comprise internal audit services. It also stated that, depending on the nature of the services, a threat to independence may be created if the services involve the firm performing management functions or are such that it would review its own work. It further indicated that assisting an audit client in the performance of a significant part of the client's internal audit activities increases the risk that firm personnel providing the service may perform a management function. Therefore, before accepting such an engagement, the firm should be satisfied that the client has designated appropriate resources to the activity. The exposure draft indicated that certain services, such as the outsourcing of all or a portion of the internal audit function, whereby the firm is responsible for determining the scope of the work and the recommendations that should be implemented, and performing procedures that firm parts of the internal controls of the audit client, involve management functions. The exposure draft therefore indicated that the auditor should not provide such services.

The exposure draft stated that a firm should only provide assistance to an audit client's internal audit function if the following conditions are met:

- (a) The client is responsible for internal audit activities and acknowledges its responsibility for establishing, maintaining and monitoring the internal controls;
- (b) The client designates a competent employee, preferably within senior management, to be responsible for internal audit activities;
- (c) The client or those charged with governance approve the scope, risk and frequency of internal audit work;
- (d) The client is responsible for evaluating and determining which recommendations of the firm to implement;
- (e) The client evaluates the adequacy of the internal audit procedures and the findings resulting from their performance by, among other things, obtaining and acting on reports from the firm; and
- (f) The findings and recommendations resulting from the internal audit activities are reported appropriately to those charged with governance.

Mr. Winetroub reported that the majority of respondents either expressly or implicitly agreed with the proposal to permit the provision of internal audit services provided that

certain specified conditions are met. Eight respondents were not supportive of, or questioned, the overall approach. These respondents expressed the following views:

- A firm that provides financial audit services should not also provide internal audit services to the same client.
- An audit firm should not provide internal audit services for a public interest entity.
- Where the auditor is likely to place significant reliance on the internal audit work performed by the audit firm, the self-review threat would be unacceptably high and such services should be prohibited, rather than allowing safeguards to be applied.
- The proposed changes to the provision of internal audit services to audit clients by audit firms were sufficiently restrictive – no further detail was provided.
- The safeguards provided are not sufficiently robust and that the Code should contain a statement that not all self-review threats can be mitigated with safeguards and that a firm may need to decline to perform certain non-audit services.

Ms. Koski-Grafer noted that IOSCO's letter had not said that there should be a complete prohibition on internal audit services, but said that the term internal audit encompassed a wide range of meanings and had many different meanings, and requested that the IESBA expand its coverage of the subject and provide rationale as to why provision of some internal audit services would be in the public interest.

Mr. Winetroub indicated that the IESBA considered these comments and, in light of the respondents who were concerned with the approach and the probable effect that the proposal would have on convergence, concluded that it was appropriate to adopt a more restrictive approach regarding the provision of internal audit services to public interest audit clients. The IESBA, therefore, directed the Task Force to develop an appropriate prohibition for providing internal audit services to public interest audit clients.

Mr. Winetroub indicated that the Task Force considered the matter and has developed a proposal that would restrict firms from providing internal audit services that relate to the internal accounting controls, financial systems or financial statements to a public interest audit client. Firms would not be precluded from providing non-recurring internal audit services to evaluate a specific matter (such as assisting the client in an investigation of a suspected fraud). He further indicated that a new paragraph had been added describing internal audit activities. This paragraph was consistent with the discussion in ISA 610 Auditor's Consideration of the Internal Audit Function.

Ms. Munro reported that the Task Force had discussed the issue of re-exposure. IESBA due process requires IESBA to determine whether re-exposure is necessary. In determining the need to re-expose a proposed pronouncement, the PIAC assesses whether, as a result of the comments received on exposure, there has been substantial change to the exposed pronouncement and, if so, whether those changes warrant the need to re-expose. She noted that although the majority of respondents supported the exposed position on internal audit, the IESBA's current view was that there should be a more

restrictive position in providing internal audit services to a public interest entity. It was, therefore, likely that re-exposure of this matter would be appropriate.

Responding to a comment by David Winetroub that the new Task Force position was in line with the U.S. SEC's approach, Ms. Koski-Grafer noted while the SEC had a more restrictive position than that proposed in the exposure draft, she recalled that in an earlier Ethics Forum, a number of attendees who had indicated that a more restrictive approach with prohibitions was appropriate were European, and so perhaps the revised approach would be helpful in working for convergence in other geographic areas as well.

Ms. Sucher expressed support for the direction of the proposed changes noting that the exposed approach was too permissive. She questioned whether the proposed changes were sufficiently broad and whether they would restrict all internal audit services that impacted the financial statements.

Mr. Winetroub responded by saying that the proposed restriction was drafted from a broad perspective in that, for an audit client that was a public interest entity, a firm could not provide internal audit services that relate to the internal accounting controls, financial systems or financial statements. Ms. Sucher noted that while she could not think of any additional examples there might be other types of internal audit activities that would impact the financial statements. Mr. Winetroub indicated that he could not think of any such services but if they did exist, the firm would still be subject to the threats and safeguards under the general provisions.

Mr. Pickeur noted that proposed paragraph 290.187 states that a self-interest threat is created if a firm "intends to use" the internal audit work in the course of a subsequent external audit. He noted that a threat would be created if the firm did use the internal audit work, irrespective of whether the firm intended to use the work. Mr. Dakdduk noted that "intends" could be seen as a more restrictive provision because, before providing the services, the firm has to assess whether the results will be used the course of a subsequent audit. Mr. Winetroub indicated this would be considered in the drafting.

Mr. Pickeur noted that the exposure draft states that assisting an audit client in the performance of a significant part of the internal audit function increases the risk that firm personnel providing the internal audit service will become part of the client's internal controls. Mr. Winetroub responded that this thought was captured in proposed 290.188(e) which indicates a firm should not perform procedures that form part of the internal control. Mr. Pickeur noted that the original drafting seemed more principles-based.

Mr. Pickeur noted that 290.189(a) would be clearer if it stated that "designates an appropriate and competent resource...to be responsible at all times for internal audit activities..." Also in 290.189(b) it might be clearer to refer to "risk analysis" as opposed to "risk". Mr. Winetroub indicated the Task Force would consider these suggestions.

Mr. Pickeur also suggested that there should be a new 290.189(f) which would state that the client's management and regulators, if any, should have access to the working papers. Mr. Winetroub indicated that this is not part of the internal audit work product.

Mr. Pickeur questioned whether forensic auditing should be addressed in the Code as it is an area that is gaining momentum. Mr. Winetroub responded that it was not within the scope of the project. Mr. Fleck noted that it might be worthwhile putting this matter on the open action list.

Ms. Koski-Grafer questioned whether the proposed revised position on internal audit could be characterized as a combination of the principles-based approach with a specific prohibition. There is a self-review threat created by providing internal audit services if the firm intends to use the work in a subsequent external audit and, for public interest entities, a natural extension of this principles-based approach is a restriction on providing internal audit services that impact the financial statements.

Mr. Sylph noted that the IAASB may revise the description of internal audit activities after considering comments on exposure. Mr. Winetroub indicated that if the IAASB changed the description, the IESBA would likely change as well. It was noted that it might be useful to footnote the description in the Code to note that it might change if the IAASB description changed.

Mr. Fleck indicated that it has come to his attention that some firms use some of an entity's internal audit personnel to assist in the conduct of the external audit. He noted that this was not within the scope of the project but wondered whether this was a common practice. Mr. Winetroub noted that it was not unusual for a firm to use internal audit staff in such a capacity. The staff usually perform audit procedures that would otherwise be performed by junior staff members of a firm. The staff would be supervised and their work subject to review – in the same manner as would be junior staff of the firm. Mr. Fleck noted that, even in work is performed by junior staff, the decision as to what matters should be reported is an important one. Mr. Fleck questioned how such the staff lending arrangement interacted with the employment provisions of the Code and whether the internal audit staff would be considered to be staff of the firm or contractors. Mr. Winetroub indicated that he was not aware of situations where internal audit staff providing assistance would be characterized as employees or contractors – rather, they remain employees of the employing entity.

Ms. Koski-Grafer noted that the discussion was a good illustration of how independence issues can be very complex.

Fees Relative Size

Mr. Winetroub reminded CAG members that the proposed revisions to Section 290 provided additional guidance with respect to the relative size of fees from an audit client that is an entity of significant public interest. When, for two consecutive years, the total fees from such a client represent more than 15% of the total fees received by the firm expressing the opinion on the financial statements of the client the self-interest threat

created would be too significant unless disclosure is made to those charged with governance of the client and one of the following safeguards is applied:

- After the audit opinion has been issued a professional accountant, who is not a member of the firm expressing the opinion on the financial statements of the client, performs a review that is equivalent to an engagement quality control review (“a post issuance review”); or
- Prior to the issuance of the audit opinion a professional accountant, who is not a member of the firm expressing the opinion on the financial statements of the client, performs an engagement quality control review.

In subsequent years, in determining which of these safeguards should be applied, and the frequency of their application, consideration should be given to the significance of the relative size of the fee. The exposure draft stated that at a minimum a post-issuance review should be performed not less than once every three years to reduce the threat to an acceptable level.

Mr. Winetroub indicated that respondents were mixed in their view as to whether a bright-line test was appropriate. Eleven respondents expressed either support for the approach or noted that they did not disagree with the proposal. These respondents indicated that the threshold was reasonable and that a specific threshold was necessary for clarity and consistent application. 14 respondents expressed the view that it was inappropriate for the Code to have a bright-line 15% test. These respondents stated that a bright-line test was not consistent with a conceptual framework approach and some also expressed concern that it might have a disproportionate impact of smaller firms and on firm concentration. Mr. Winetroub indicated that the IESBA has considered the comments and is of the view that a fixed threshold percentage is necessary to ensure consistent application. The IESBA is not, therefore, proposing to change the threshold requirement.

Mr. Winetroub reported that exposure draft proposal that after the 15% threshold had been reached this fact should be disclosed to those charged with governance was supported by the majority of respondents to the exposure draft.

With respect to the pre or post-issuance review, nine respondents expressed support for the proposal and four respondents expressed the view that only a pre-issuance review would be sufficiently robust. Mr. Winetroub indicated that the IESBA has considered the comments and is of the view that the guidance should be strengthened to require the application of safeguards to the second audit opinion that is issued after the fees reach the 15% threshold. In addition, the proposal will be strengthened to state that when the fees significantly exceed 15%, the firm should determine whether the significance of the threat is such that a post-issuance review could not reduce the threat to an acceptable level, and, therefore, a pre-issuance review is required.

He further reported that, in response to comments additional guidance had been added regarding fees from a client that represent a large proportion of the revenue from an individual partner or office.

Mr. Haaning expressed concern that the proposed revisions indicated that a regulator might be part of the process by performing a pre-issuance review. Mr. Winetroub indicated that, although this was likely to be the exception rather than the rule, it was the view of an IESBA that if a regulator was prepared to perform a pre-issuance review this would be an effective safeguard.

Mr. Pickeur stated that he found the section difficult to understand and that the Code should make it impossible for a firm to be dependent upon an assurance client. Mr. Winetroub responded that it was quite common on the very large audits for the fees from that client to be very significant to the lead partner or the office of the lead partner. This was a reality and it was important that effective safeguards are applied to address the threat.

Mr. Pickeur noted that the language seemed too permissive in that it stated “safeguards should be considered”. Mr. Winetroub noted that issue of permissiveness of language would be addressed in the drafting conventions project.

Mr. Fleck asked if a partner had only one large client whether a useful safeguard would be use of “opinion committees” and whether this would be more effective than an engagement quality control review. Mr. Winetroub responded by saying that international standards on auditing require all firms that audit listed entities to have procedures and requirements for engagement quality control reviews and that there were standards for the performance of such reviews. He was not aware, however, whether opinion committees were commonly used.

Mr. Hegarty questioned whether the safeguard that an engagement quality control review performed by someone from a network firm would always be effective. For example, to what extent would the review fall under the jurisdiction of the signing firm? To what extent would the reviewing firm also have responsibility for the outcome of the audit? Mr. Winetroub noted that protocols could be put in place to address the issue. In addition, if in a particular jurisdiction the engagement quality control review is required to be performed by a member of the firm, the safeguard would require an additional engagement quality control review.

Mr. Hegarty questioned whether, if the reviewing firm was not liable, there was sufficient incentive for the engagement quality control reviewer to perform an appropriate review and, consequently was this was a sufficiently robust safeguard. Mr. Sylph responded that if there was substandard performance on the part of the engagement quality control review, the relevant member body could discipline the individual. Mr. Hegarty indicated that it was, therefore, important that the engagement quality control review is performed by a member of a member body of IFAC. Mr. Winetroub indicated that the safeguard required a review by a professional accountant which is defined in the Code as an individual who is a member of an IFAC member body.

Ms. Koski-Grafer stated that the concern expressed by IOSCO in their comment letter was that the issue of economic dependence should be addressed in a very broad and

principles-oriented manner, as the threat was not just at the firm audit fees level but could also arise with important clients at the partner level or the office level. She was pleased to see that some change was proposed and that the matter had been discussed, and noted that even if the full range of issues involved could not be addressed in a standard at this time, it was important to raise awareness on this matter in the consciousness of accountants and the public. She indicated that there was an opportunity for IESBA to increase awareness in this area through information and education on the issue and on some of the measures were used in practice by audit firms and audit committees.

Contingent Fees

Mr. Winetroub indicated that the exposure draft provided additional guidance with respect to contingent fees. Under the proposed revisions a firm should not perform a non-assurance service for an audit client if either the fee is material, or expected to be material, to the firm or the fee is dependent upon the outcome of a future or contemporary judgment related to the audit of a material amount in the financial statements. In the case of a non-assurance service provided to an assurance client that is not an audit client, a firm should not provide a non-assurance service for a contingent fee if the amount of the fee is dependent on the result of the assurance engagement.

He indicated that while the majority of respondents to the exposure draft were generally supportive of the position in the exposure draft there was some disagreement. Four respondents were of the view that a firm should not charge any contingent fees to an audit client; two respondents were of the view there should be specific guidance on tax; two respondents were of the view that the guidance should include a prohibition on a contingent fee arrangement between the firm and a third party; and one respondent felt the guidance should address contingent fees charged by a network firm.

The IESBA and Task Force considered these comments and proposes the following changes:

- Clarification that a contingent fee cannot be charged directly or indirectly;
- Expansion of the guidance to include a restriction on:
 - Network firms that participate in a significant part of the audit from charging a material contingent fee; and
 - Charging a contingent fee for a non-assurance service where the financial statements amounts are material and will be the subject of a significant future or contemporary audit judgment.

In addition, Section 291 has been aligned with Section 290.

Mr. Ray questioned how the materiality of the fee would be calculated. Mr. Winetroub responded that, as with any materiality calculation, it would require professional judgment. He noted that there was a two-fold test for the firm expressing the opinion on the financial statements: the contingent fee cannot be material to that firm; and the fee cannot relate to a matter that would be the subject of a significant future or contemporary audit judgment.

Mr. Ray noted that, for a large firm, the size of the fee could be quite significant. Mr. Winetroub responded that if the fee is clearly de minimus it would not be an issue but as the fee increases in size the significance of any threat increases. The IESBA is of the view that when the fee becomes material the threat would be too significant.

Mr. Fleck indicated that there would be some contingent fees which would not create an unacceptable threat. For example, performing VAT work for a contingent is standard work. Ms. Koski-Grafer noted that in the US, such an approach would be seen as creating a mutuality of interests. Mr. Winetroub noted that the SEC and PCAOB prohibit all contingent fees for audit clients.

Ms. Todd McEnally noted that what was proposed was a substantial improvement from the existing Code, but sensed a reluctance to just say no. She noted that in the view of investors, the auditor performs a critical role in the capital markets, and indeed for non-listed entities. If auditors are to act in the public interest, their role needs to be clearly understood which means that the direction needs to be unambiguous such that two people would reach the same conclusion. She further noted that it was her hope that once the current round of changes was complete the Code would not then be cast in stone but would be reviewed to ensure it was up to date. She expressed her view that the Sarbanes-Oxley changes were the result of ethical issues.

Mr. George responded and noted that while the Code will be revised from time to time, respondents had called for a period of stability to allow for proper implementation of the proposed changes. He also noted that the IESBA was establishing a global Code and while, for example, the proposed position on contingent fees was not as restrictive as the SEC position it was as stringent as the position in the UK.

Mr. Fleck noted that it was easy to forget that Section 290 is only part of the Code. The Code contains fundamental principles to drive appropriate behaviour.

Mr. Cassel stated that it was difficult to reach a conclusion as to whether the proposed position was sufficiently robust or whether, for example, there should be an outright prohibition. He noted that he has been consulted on various scenarios and had tended to take quite a stringent approach, encouraging the firms not to structure a particular service for a contingent fee. He noted that, in one particular case, the firm indicated at a later date that they were glad they had not accepted a particular assignment for a contingent fee. He stated that it was important that the firm thought through all the factors.

Ms. Sucher noted that it was important to have a Code that was clear and robust. She further noted that, during the period of stability, it would be important to monitor whether any changes were necessary. In this regards it might be useful to consider matters reported by auditor oversight bodies.

Mr. Fleck agreed that it would be important for IESBA to monitor the performance of the Code to determine whether change was needed. There does, however, need to be a period of stability.

D. Implications of the IAASB Clarity Project on the Code

Mr. Dakdduk, Drafting Conventions Task Force Chair, introduced the topic. He noted that at its January 2008 meeting, the IESBA had considered proposals of the Task Force to improve the clarity of the Code, including how to address the implications of the IAASB's Clarity project for the Code. He noted that the CAG agenda papers reflected the matters proposed at the January IESBA meeting. The Task Force met on March 3, 2008 to consider the direction it received from the IESBA and, in his presentation Mr. Dakdduk updated the CAG on the results of the Task Force's March 3 meeting. The Task Force will meet again before the IESBA meeting in April.

The Task Force plans to ask the IESBA to approve an exposure draft containing proposed drafting conventions at the IESBA's April meeting. The exposure draft will reflect the drafting/clarity changes proposed throughout the Code, including the revised Section 290 and new Section 291. It is anticipated that a revised Code reflecting all the drafting changes and changes from Independence I and Independence II will be issued by the end of 2008.

Mr. Dakdduk indicated that the IESBA was not proposing to adopt the IAASB clarity conventions that involved stating the objective for each ISA or differentiating between requirements and application material. As currently drafted, Part A of the Code establishes the fundamental principles of professional ethics for professional accountants and provides a conceptual framework for complying with 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 is compliance with the fundamental principles described in paragraph 100.4 of the Code. The conceptual framework approach to complying with those principles calls for accountants to identify threats to compliance with the fundamental principles and, when necessary, apply safeguards to eliminate the threats or reduce them to an acceptable level. The IESBA concluded 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. The IESBA was, however, proposing to use the word “shall” to designate a requirement and refrain from using the present tense.

Mr. Dakdduk indicated that the word “shall” will be used to designate a requirement to comply with a fundamental principle and to establish a clear prohibition (for example, a professional accountant shall not be associated with something). The effect of such an approach would be that the word “shall” will be used frequently through the Code. He noted that respondents to the December 2006 exposure draft expressed concern that the Code seems to be moving towards a more rule-based approach and the use of “shall” could exacerbate this concern. The IESBA is, however, of the view that the use of the word “shall” is important for the clarity of the Code and specific requirements are not inconsistent with a principles-based approach, provided the requirements flow from the application of the principles. He also noted that the IESBA was not proposing to redraft a

requirement to contain the word “shall” if the requirement was already clear from the existing drafting.

Mr. Ray noted that the IAASB use of the term “shall” denoted a specific meaning and he questioned whether IESBA would be using the meaning in the same way as in the ISAs. Ms. Sucher noted that the use of the term “shall” was used to specify a requirement designed to achieve a stated objective and that in exceptional circumstances where the professional accountant judges it necessary to depart from a requirement in order to achieve the purpose of that requirement, the accountant will be required to document how the alternative procedures performed achieve the purpose of the requirement and, unless otherwise clear, the reasons for the departure. Mr. Dakdduk stated that is not how “shall” would be used in the Code; i.e., there would be no ability for an accountant to elect not to comply with something the Code says shall (or shall not) be done. Mr. Fleck noted that Section 290 states that the auditor has to be independent and that the requirements should be read in light of this objective. Mr. Dakdduk stated that the Task Force would consider whether it was appropriate to indicate what the IESBA intends by the word “shall.”

Mr. Pickeur questioned the meaning of the statement that the IESBA was not proposing to redraft a requirement to contain the word “shall” if the requirement was already clear from the existing drafting. He asked whether this meant that the Code would continue to use the term “should.” Mr. Dakdduk indicated that this was not the intention, rather, if the Code stated that the professional accountant was “required to” do something this would not be changed to state that the accountant “shall” because the existing requirement is already clear.

Mr. Haaning stated that the Code should contain some flexibility for situations where it might be appropriate for a professional accountant to depart from a requirement conveyed by use of the word “shall.” Mr. Damant stated that it was a very important point of principle as to whether any such flexibility was needed or desirable. Mr. Dakdduk indicated that the IESBA’s view was that the requirements in the Code were mandatory and, as such, there should be no flexibility to enable accountants to depart from a requirement. Ms. Sucher noted that the Code contained provisions to address inadvertent violations of the Code but this was a different matter.

Acceptable Level

Mr. Dakdduk explained that the Code currently requires professional accountants to apply the conceptual framework to identify threats to compliance with the fundamental principles, to evaluate their significance and, if such threats are other than clearly insignificant to apply safeguards to eliminate them or reduce them to an acceptable level such that compliance with the fundamental principles is not compromised. He indicated that the IESBA plans to eliminate the use of “clearly insignificant” and require the accountant to:

- Identify threats to compliance with the fundamental principles;
- Evaluate the significance of the threats; and
- Apply safeguards, when necessary, to reduce eliminate the threats or reduce them to an acceptable level.

The IESBA also plans to provide the following definition of an acceptable level:

“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.”

As a result of this proposed change, there would also be a conforming change to the documentation requirements in the Code. Mr. Dakdduk noted that International Standards on Auditing require documentation of conclusions regarding compliance with independence requirements and any relevant discussions that support those conclusions. Mr. Dakdduk explained that the Code would refer to this requirement and call for the existing documentation requirement in the Code to apply when safeguards have been applied to eliminate or reduce threats. The proposed documentation requirement in the Code would be:

“Documentation is not, in itself, a determinant of whether a firm is independent. International auditing standards 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 also describe the nature of those threats and the safeguards applied to eliminate the threats or reduce them to an acceptable level.”

Ms. Koski-Grafer questioned whether the phrase “apply safeguards, when necessary” was the appropriate construction, or if more specific language such as “apply safeguards whenever a threat was not trivial or inconsequential, or was not insignificant” would be more appropriate. Mr. Dakdduk responded that the meaning was that if, having evaluated the significance of identified threats, the accountant concluded that the threats were not at an acceptable level, safeguards shall be applied to eliminate the threats or reduce them to an acceptable level. He noted that the Task Force intends to recommend that this full construction be contained in paragraph 100.2 to make clear that this is what is meant by “when necessary.” Ms. Koski-Grafer noted that it was important that the Code was clear on this matter and that the language did not take a short-cut.

Ms. Chin questioned the continuum of threats. She questioned whether the continuum ranged from clearly insignificant, insignificant, significant, clearly significant etc. Mr. Dakdduk indicated that the IESBA was of the view that the requirement was that the threats should be at an acceptable level and was proposing to define what was meant by acceptable level.

Mr. Ray questioned whether the elimination of “clearly insignificant” would change the auditor’s thought process. Under the current Code if a threat is clearly insignificant the auditor does not have to give the matter any further thought. It is only threats that are other than clearly insignificant that need to be considered further. Mr. Dakdduk responded that the proposed change would still require the auditor to identify and evaluate the significance of all threats and in determining whether the threats were at an

acceptable level the auditor would consider what a reasonable and third party would be likely to conclude.

Mr. Hegarty expressed the view that a difference is created because under the existing Code if a threat is above clearly insignificant, there is a documentation requirement if the firm decides to accept or continue the engagement. Under the proposed change, documentation is only required when the initial threat is above an acceptable level such that safeguards are necessary. Ms. Koski-Grafer noted that the starting point and the ending points were unchanged – that is the accountant would still be required to identify and evaluate the significance of all threats and apply safeguards to reduce identified threats to an acceptable level.

Mr. Ray questioned whether a better definition of acceptable level would be a level at which a reasonable and informed third party *would* conclude that compliance with the fundamental principles is not compromised. Mr. Dakdduk said the Task Force would consider this.

Mr. Pickeur questioned whether the definition of an acceptable level should include the concept of a knowledgeable third party. Mr. Dakdduk responded that in his view this was incorporated in the concept of informed third party. Ms. Koski-Grafer noted that the concept of a reasonable and informed third party is not well understood in some jurisdictions.

Mr. Pickeur questioned whether the definition of an acceptable level would be clearer if it referred to compliance with the requirements in the Code, rather than compliance with the fundamental principles. Mr. Dakdduk noted that this construction was consistent with the current construction of paragraph 110.2 and that the objective under the Code is for professional accountants to comply with the fundamental ethical principles set out in the Code.

Mr. Bradbury questioned whether the reference to “specific facts and circumstances” was sufficiently clear. He noted that it did not address hindsight. Mr. Fleck indicated that this could be addressed by including wording such as “available at that time.” Mr. Dakdduk agreed to raise this with the Task Force. It was noted that the proposed construct is already used in the definition of independence in appearance and in the guidance on network firms and, therefore, any such change to acceptable level would need to be considered with respect to other parts of the Code.

Mr. Hegarty questioned whether the acceptable level should be defined in terms of independence, because the third party is interested in whether the auditor is independent. Mr. Dakdduk noted that the acceptable level applies to all of the Code and therefore refers to compliance with all the fundamental principles.

Consider/evaluate/determine

Mr. Dakdduk indicated that in reviewing the Code for clarity, the IESBA noted that in many instances the word “consider” has been used in the Code to convey a requirement

that the accountant make a decision. Because “consider” could be seen by some as conveying something short of a requirement to decide or conclude on a matter, the IESBA proposes changes to the Code consistent with the following principles of drafting:

- “Consider” will be used where the accountant is required to think about several matters
- “Evaluate” will be used when the accountant has to assess and weigh matters as in “the significance of the threat should be evaluated”
- “Determine” will be used when the accountant has to conclude and make a decision

Ms. Sucher commented that it was useful to clarify the intention. She also indicated that it would be useful to have a trail so that respondents could see how the changes had been applied. She further noted that paragraph 100.15 used the term “consider” and she could see that it might be better expressed using “determine” or “evaluate.” Mr. Dakdduk indicated that the Task Force will review the paragraph but as drafted it did seem that “consider” was appropriate because the paragraph required the professional accountant to include in his consideration the ways in which a third party might conclude.

Ms. Koski-Grafer asked if a mapping document would be provided showing how the Code has been changed from the existing Ethics Code during the standards project, and emphasized the importance of showing the thought process and evolution of changes from the beginning to the end.. Ms. Munro indicated that the exposure draft would contain a mark-up of the changes from the previous exposure draft and the accompanying explanatory memorandum would provide the taxonomy and indicate which paragraphs had been changed. Ms. Koski-Grafer said that what would be of most interest to IOSCO would be the cumulative effect of all changes made, so that regulators could assess the impact of all the successive changes from a public interest standpoint.

Mr. Hegarty questioned the interaction of the ISA documentation requirement and the Code documentation requirement. Mr. Dakdduk responded that the first part of the proposed documentation paragraph in the Code recognizes that ISA 220 requires documentation of conclusions regarding compliance with independence requirements and any relevant discussions. The second part of the paragraph addresses the requirement to document in cases when threats are identified that require the application of safeguards. He further noted that the IESBA was of the view that if a threat was not clearly insignificant but was at an acceptable level it was not necessary to document that threat.

Mr. Hegarty expressed the view that it was important for there to be documentation when there were threats that were other than clearly insignificant. If the auditor concludes the threats are at an acceptable level, this is an important matter and should be documented. Mr. Fleck expressed the view that it was important that there was some documentation when a matter was “close to the line.” Mr. Dakdduk responded that the ISA requires documentation of the conclusion and any relevant discussions that support the conclusion and, therefore, this would seem to address documentation of matters that were “close to the line.” He indicated that the Task Force would consider this.

Mr. Diomeda expressed the view that he thought the proposed change was clear and that he was in favour of the approach as it was a logical consequence of eliminating the term “clearly insignificant”.

Threats

Mr. Dakdduk noted that while the Code describes the different categories of threats (for example, self-review, self-interest, etc.) it does not describe what is meant by a “threat” or how a threat is created. The Task Force was, therefore, proposing that the Code describe a threat as follows:

“Threats may be created by a broad range of relationships of other facts and circumstances that could compromise a professional accountant’s compliance with the fundamental principles”.

He indicated that with this change, many of the relationships and circumstances described in the Code would create a threat – which would require changing the phrase “may create a threat” to “create a threat.”

Ms. Todd McEnally stated that this seemed reasonably clear but she wondered whether it was envisaged that the appearance of compliance would be addressed. Mr. Dakdduk indicated that “appearance” would be addressed.

Ms. Koski-Grafer stated that ISOCO had commented that the prevalence of the use of “may create” in the Code undermined the strength of the Code. The proposed changes therefore appear to be a step in the right direction.

Mr. Fleck noted when going through the document it was possible to see why “creates a threat” had been used instead of “may create a threat.” He indicated that at the IESBA meeting some members, particularly from Europe, expressed concern that the approach might move the Code away from a principles-based approach. He asked Ms. Blomme whether, as a FEE representative, she had any views on the matter. Ms. Blomme responded that, based on the CAG papers, considering the principle the approach seemed appropriate.

Mr. Sylph questioned whether the proposed change of the definition of a threat would require additional documentation. Mr. Dakdduk responded that the drafting of the description was not driven by the documentation requirement.

Mr. Pickeur stated that it might be clearer if the description of a threat was split into two sentences. The first sentence would say that threats could compromise a professional accountant’s compliance with the fundamental principles. The second sentence would say that threats may be created by a broad range of circumstances.

Mr. Dakdduk reported that the IESBA had considered the five categories of threats and had determined that their description could be improved. He noted that the Task Force had further refined the descriptions contained in the CAG papers. He reported that the Task Force’s current description of a self-interest threat was:

“The threat that a professional accountant’s financial or other interests will inappropriately influence the accountant’s professional judgment or behavior.”

Mr. Fleck noted that a better construction for the description might be “A self-interest threat is the risk that a professional accountant’s...”

Mr. Haaning questioned whether the word “inappropriately” was necessary. Mr. Dakdduk responded that the Task Force wanted to convey the negative effect. He noted that an interest could have a positive impact because, for example, a professional accountant’s concern about losing their professional license might have a positive impact on professional judgment.

Mr. Dakdduk reported that the Task Force’s current description of a self-review threat was:

“The threat that a professional accountant will not appropriately re-evaluate a previous judgment or service that requires re-evaluation because the professional accountant, or another individual within the firm or organization, was responsible for that previous judgement or service.”

Mr. Fleck asked whether “re-evaluate” applies only in the context of an audit. Mr. Dakdduk responded that the threat applied to the whole Code and therefore addresses all services and professional accountants in business. Mr. Fleck questioned how this approach reconciled with the requirement that an audit rely on the last year’s work for the opening numbers. Mr. Dakdduk responded that this would be included. Mr. Fleck noted that he thought the threats associated with the need to rely on the audit work performed in the previous period was different from the threats associated with performing a valuation that is reflected in the financial statements. Ms. Koski-Grafer noted that the requirement was that the threat be at an acceptable level and, if the threat was an inherent part of the audit, such as reliance on the prior year’s work, this would create a different level of threat.

Mr. Sylph expressed concern that the proposed drafting included the re-evaluation of work performed by other people within the organization. He noted that there was a difference between a “review” threat and a “self-review” threat. Ms. Koski-Grafer noted that there is a difference for professional accountants in public practice because when you are a partner in a firm you are colored by the actions of others within your firm.

Mr. Dakdduk reported that the Task Force’s current description of an advocacy threat was:

“The threat that a professional accountant who promotes a client’s or employer’s position will do so to the point that his or her objectivity is compromised.”

Mr. Fleck noted that the APB had struggled with the definition of an advocacy threat because the definition could easily become circular because objectivity is a fundamental principle.

Mr. Dakdduk reported that the Task Force's current description of a familiarity threat was:

"The threat that, due to a long or close relationship with a client or employer, a professional accountant is too sympathetic to their interests or too accepting of their work or representation."

Mr. Damant noted that this threat might be problematic for professional accountants in business. Ms. Koski-Grafer noted that a professional accountant is supposed to be loyal to the employing organization but not to the extent that one compromises compliance with the fundamental principles. Mr. Fleck noted that a key word is "accepting." He noted that this may be a challenge in some jurisdictions but it was an appropriate challenge.

Ms. Sucher questioned whether the bullets on paragraph 200.7 were in the right order.

Mr. Dakdduk reported that the Task Force's current description of an intimidation threat was:

"The threat that a professional accountant may be deterred from acting objectively by pressure, actual or perceived, or will subordinate judgment to that of a client or employer because of their reputation or because of their attempts to exercise undue influence over the professional accountant."

Ms. Sucher questioned whether the last two lines of the definition were repetitive. Mr. Fleck noted that the phrase "undue influence" was probably more appropriate than "pressures, actual or perceived."

Mr. Damant suggested the list of examples include the threat of not getting a promotion. Mr. Fleck noted that another example could be the threat of a client dropping a non-audit service.

Other

Ms. Blomme reported that when the FEE Ethics Working Party had reviewed the CAG papers it was noted that there were a few instances where the word "generally" had been deleted and this seemed to change the meaning. Mr. Dakdduk indicated that the Task Force was reconsidering this matter.

Ms. Blomme stated that it was important that the exposure draft clearly explain the changes that had been made and provided a rationale for the changes.

Ms. Koski-Grafer expressed a personal positive reaction to the proposed changes and noted that the changes were improving the clarity of the Code.

Mr. Cassel stated that the progress towards providing a clearer description of the threats was promising. He further noted that it was very important that the end result be consistent and coherent. He also indicated that his preliminary reaction was that it would be useful to describe a threat as a risk.

Mr. Sylph noted that the construction of “he or she” was not consistent with other IFAC pronouncements which are not gender specific and use a neutral term such as “auditor” or “accountant.”

Mr. George indicated that the IESBA planned to approve the exposure draft at its April 2008 meeting, consider the comments received at its October meeting and then approve the revised Code at its December meeting.

Mr. Dakdduk thanked CAG members for their input and indicated that the Task Force would carefully consider all comments.

E. PIOB Comments

Sir Bryan Nicholson stated that while he had observed an IESBA meeting, this was his first opportunity to observe the Ethics CAG. He noted that, when compared with the IAASB CAG, he was struck that the IESBA CAG was significantly smaller than the IAASB CAG. He noted that it was important that the IESBA CAG membership be increased to ensure that a wide range of stakeholders was represented at the table. In addition, if the membership of the CAG was expanded it would be more likely that the discussions remain at a higher level as opposed to at the detailed wording level. He recognized that it was important that the timing of CAG meetings be co-ordinated with the IESBA meetings to ensure that input is provided at the right moment. He noted, however, that scheduling additional meetings, especially when they are not connected to an IESBA CAG meeting can be problematic for members.

Sir Bryan Nicholson stated that we was pleased with the IESAB presenters and how they were very open minded to suggestions provided by CAG members. He indicated that this was an important part of due process.

Sir Bryan Nicholson noted that while it was important that the Code be reviewed to ensure that it was current and appropriate, if the drafting was careful and developed to solicit the right behaviour characteristics the Code would not be something that it re-written every two or three years.

Sir Bryan Nicholson wished the Ethics CAG well in its further deliberations.

F. Closing

Mr. Fleck noted that, given the timing of the IESBA approval for the revised Code, the CAG needed to meet between the October and December IESBA meetings. CAG members agreed that the CAG should meet again in late November.

CAG members discussed whether, in light of the additional November meeting, the September meeting should be held. Members decided to hold the meeting noting that, at a minimum, CAG members could obtain an overview of the comments received on the drafting exposure draft and would also discuss the new projects that the IESBA plans to discuss at its Toronto meeting.

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

G. Future Meeting Dates

September 3, 2008 (Toronto, Canada)

November 24, 2008 (London, UK)