Minutes of the Meeting of the International Ethics Standards Board for Accountants January 21-23, 2008 Amsterdam Netherlands

	Members	Technical Advisors
Present:	Richard George (chair)	
	Frank Attwood	Neil Lerner
	Margaret Butler	Bill Cordes
	Ken Dakdduk	Lisa Snyder
	David Devlin	Andrew Pinkney
	Robert Franchini	Sylvie Soulier
	Kariem Hoosain	
	Alice McCleary	Tiina-Liisa Sexton
	Barbara Majoor	Bert Oosterloo
	Michael Niehues	Petra Gunia
	Carmen Rodriguez	
	Jean Rothbarth	
	Volker Röhricht	Tim Volkmann
	Robert Rutherford	
	Isabelle Sapet	Jean-Luc Doyle
	Aiko Sekine	Roman Adler
	David Winetroub	Peter Hughes (Day 1 and 2 only)
Regrets:	Lady Barbara Judge	Heather Briers
		David Hastings
		Rethabile Kikine
	Non-Voting Observers	
Present:	Juan Maria Arteagoitia	
	Richard Fleck	
	Toshi Kurosawa (Day 2 & 3 only)	Tomokazu Sekiguchi (Day 2 & 3 only)
	Bella Rivshin	

Prepared by: Jan Munro

PIOB

Present Arnold Schilder (Day 1 only)

Antoine Bracchi (Day 1 in part and Days 2 & 3)

IFAC Technical Staff

Present: Jan Munro

Jim Sylph

1. Introduction and Administrative Matters

Mr. George opened the meeting and welcomed all those attending. He thanked the Royal NIVRA for hosting the meeting.

Mr. George welcomed new members Alice McCleary, and her technical advisor Tiina-Liisa Sexton, Isabelle Sapet, Robert Franchini, and Aiko Sekine and her technical advisor Roman Adler. Mr. George noted that apologies had been received from Lady Barbara Judge who had given her proxy to David Devlin. He also indicated that apologies had been received from technical advisors: Heather Briers; David Hastings; and Rethabile Kikine.

Minutes of the Previous Meeting

Mr. George indicated that the minutes were presented for approval. Mr. Devlin indicated that, with reference to the discussion on convergence, it was his recollection that, at the October meeting, the IESBA had determined that the program and course of action to promote recognition of the Code should be started before the current revisions to the Code were finalized. The IESBA agreed that this was the decision taken at the October meeting and further agreed that the minutes should indicate that this would start no later than March 2008. Subject to this change, and some editorial matters, the minutes of the public session of the October 2007, IESBA meeting were approved as amended.

Planning Committee

Mr. George reported that the Planning Committee had not met since the October 2007 meeting but would be meeting before the April 2008 meeting to develop the program and course of action on convergence.

Outreach

Mr. George reported that he had participated in a panel discussion at the SMP Forum held in Malta and had also participated in a roundtable as part of the IFAC Council activities. At both of these events some had indicated that the proposed changes to independence requirements would be challenging for SMPs. He had stressed that the majority of changes relate to the audit of public interest entities.

Mr. George reported that Mr. Attwood had made a presentation on the proposed changes to the Code to accountants in Cyprus.

IESBA CAG Meeting

Mr. George reported that the IESBA CAG had met in December 2007 and had discussed Independence I and the decisions taken in Toronto on the Drafting Conventions project. The draft minutes from the meeting were included in the agenda papers. He noted that he was pleased that several IESBA members and TAs had observed the meeting and he encouraged members and TAs to observe a CAG meeting when it was held in a convenient location. He reported that the next CAG meeting would be held on March 5-6, 2008 in Basel, Switzerland.

Global Public Policy Forum

Mr. Sylph reported that his observation from attending the Global Public Policy Forum was that convergence of independence standards did not seem to be high on the agenda of participants. In this regard, the sooner the IESBA can start its promotion of the Code the better.

Other

Mr. George reminded the Board of two important comments made by the PIOB member observing the October 2007 IESBA meeting. The first comment related to participation by Board members. The PIOB member had noted that some members had been quite active in the meeting while others had said very little and the PIOB encouraged all to participate in the meeting. The second comment related to the balance of participation by Board members and technical advisors. The PIOB was of the view that if there was too much input from technical advisors this would have the effect of distorting the Board's deliberations. Mr. George reported that outside of the meeting he had also had some discussion with the PIOB member which he thought was useful. The discussion related to the input from the Task Force members at the Board meeting. The Task Force is responsible for presenting the proposals to the Board and the Board is responsible for debating and challenging the proposals. In this regard it would be useful if Task Force members allowed the other Board members to debate the matter before expressing, for example, a dissenting opinion. The Board discussed these matters and the following points were noted:

- If this latter approach is to be taken, the Task Force chair might need to inform the Board of any dissenting views that exist within the Task Force; and
- A view was expressed that a Task Force member should be able to raise a contrary view that had been discussed but rejected by the majority of Task Force members.

Mr. George indicated that there was no intent to discourage debate, rather the intent was that Task Force members hold back somewhat in the initial discussion to permit other Board members to express their views.

2. Independence I

Ms. Rothbarth, Independence I Task Force chair, reported that the Task Force had met twice since the October 2007 IESBA meeting and had held one conference call. The CAG discussed a draft of the proposals at its meeting on December 11, 2007. The Task Force considered and responded to the input of the CAG at its Task Force meeting the following day and the proposals presented in the agenda papers incorporated these changes.

Public Interest Entities

Ms Rothbarth reported that, in response to comments received from the IESBA at its October meeting and comments from the CAG, the Task Force had revised the definition of public interest entities to comprise:

- all listed entities;
- any entity defined by a regulator or by legislation as a public interest entity; and
- any entity for which a regulator or legislation requires either the audit to be conducted in accordance with the auditing standards that are applicable to listed entities or the firm to comply with the ethical requirements that are applicable to the audit of listed entities.

With respect to the proposal that firms and member bodies would be encouraged to consider whether additional entities should also be treated as public interest entities because they have a large number and wide range of stakeholders, the Task Force was proposing that the following factors would be considered:

- The nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders. Examples may include financial institutions, such as banks and insurance companies, and pension funds;
- Size; and
- Number of employees.

Ms Rothbarth reported that the Task Force had carefully considered the comment from a CAG member that regulated banks should always be treated as public interest entities because they accept money from the public. She noted that the Task Force was of the view that other institutions accept money from the public – for example insurance companies, pension funds and credit unions. The Task Force was concerned that including such entities as public interest entities would inappropriately expand the definition. The Task Force also recalled the concern expressed by many respondents to the exposure draft which indicated that public interest entities will "normally include regulated financial institutions such as banks and insurance companies".

The IESBA discuss the proposals and the following points were noted:

- The third part of the definition ("any entity for which a regulator or legislation requires either the audit to be conducted in accordance with the auditing standards that are applicable to listed entities or the firm to comply with the ethical requirements that are applicable to the audit of listed entities.") was not clear;
- The third part of the definition should refer only to independence standards and should not refer to auditing standards;

- Whether, if a regulator has the authority to require the auditors of certain entities to comply with the more stringent independence requirements that apply to listed entities, it was necessary to address that in the Code; and
- The Code is written for accountants as opposed to providing direction for regulators

After further discussion, the Board agreed that the definition should be changed to:
- all listed entities; and
- any 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 relevant regulator, including an audit regulator.

Non-Assurance Services Provided Before Client Becomes an Audit Client
Ms. Rothbarth reported that, at the CAG meeting, a CAG member 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. The member questioned whether the Task Force had considered whether there might be other safeguards or remedies, in addition to those listed in the bulleted items, to deal with situations where a firm had been engaged to provide prohibited services and it would be difficult to complete the work prior to being engaged to do an audit. Such safeguards might include having a discussion with the regulator and coming to a resolution as to whether there might be an appropriate workout action to take. The CAG member noted that this could be a practical solution in some situations and was an action that took place in practice on occasion.

Ms. Rothbarth indicated that the Task Force had considered this matter and was proposing to revise the paragraph to state that:

- If the non-assurance services would not be permitted during the period of the audit engagement, the audit engagement should only be accepted if safeguards are applied to eliminate the threats or reduce them to an acceptable level;
- If, however, the non-assurance service has not been completed, and it is not practical to complete or terminate the service, before starting the commencement of professional services in connection with the audit, the firm should discuss the matter with those charged with governance and only accept the engagement if:
    - The non-assurance service will be completed within a short period of time; or
    - The client has arrangements in place to transition the service to another provider within a short period of time.

The IESBA discussed the proposal and the following points were noted:

- If the approach was adopted it was important that there was a discussion with those charged with governance as opposed to just a reporting to those charged with governance;

- The approach could be seen as too permissive and would not encourage firms to terminate the non-assurance services as soon as was possible;
- Whether all non-assurance services would still be permitted if, for example, the services involved management functions;
- Whether the additional guidance should be structured to address situations where an entity is acquired by an audit client and the firm was providing non-assurance services to the acquired entity;
- Whether "a short period of time" would be capable of consistent interpretation;
- The Code contains guidance for inadvertent violations;
- Whether the discussion with those charged with governance should be strengthened to approval; and
- The majority of the prohibited non-assurance services relate to services that are material to the financial statements.

The IESBA considered whether the provision should be written from a more restrictive perspective to indicate that the non-assurance service should only be continued if there would be significant damage to the client if the service was terminated.

After discussion, the IESBA determined that the paragraph should not be modified.

Partner Rotation
Ms. Rothbarth reminded the IESBA that it had determined that partner rotation would be required except when a firm has only a few people with the necessary knowledge and experience to serve as key audit partner and an independent regulator in the jurisdiction had provided an exemption from partner rotation in such circumstances and specified alternative safeguards.

Ms. Rothbarth reminded the IESBA that when rotation was required an individual who had served as key audit partner for seven years a two-year "time-out" period was required. During this period the individual should not participate in the audit of the entity, provide quality control for the engagement, consult with the engagement team or the client regarding technical or industry-specific issues, transaction or events or otherwise directly influence the outcome of the engagement.

Ms. Rothbarth noted that proposed definition of a key audit partner was:

> "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 upon 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."

Engagement Team
Ms. Rothbarth noted that the proposed definition of engagement team was:

> "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 external experts engaged by the firm or a network firm."

Valuation Services
Ms. Rothbarth indicated that in addition to a prohibition on providing material valuation services to an audit client that was a public interest entity, additional guidance was given on the meaning of significant subjectivity.

The IESBA discussed the proposals. A view was expressed that that the majority of valuations were subjective and two professionals would give two different values. Ms. Rothbarth responded that, for non-public interest entities, the Code proposed that a firm could not provide a valuation service if it was material and involved a significant degree of subjectivity. A view was expressed that it might not be known whether the valuation would be material until the valuation had been performed. It was also noted that if there was a risk that the valuation would be material the firm should not accept the engagement.

Taxation Services
Ms. Rothbarth noted that, at its October 2007 meeting, the IESBA concluded that tax valuations should be explicitly addressed in the Code under the taxation section and asked the Task Force to develop such guidance. Ms. Rothbarth reported that the Task Force was of the view that valuations for tax purposes generally do not threaten independence if the results of valuation are not directly reflected in the financial statements of if the effect is immaterial, or if the valuation is subject to external review by a tax authority or similar regulatory authority. If the valuation is not subject to external review and it is material, the significance of the threat should be evaluated and, if other than clearly insignificant, safeguards should be applied to eliminate the threat or reduce it to an acceptable level. If the results of the valuation service will have a direct effect on the financial statements the valuation services provisions would apply.

Other
In reviewing the remainder of the proposed changes, a question was raised as to whether the requirement in 290.116 was too stringent in relation to inheritances. It requires immediate disposal or removing the member from the team. The IESBA discussed the matter and concluded that the requirement was appropriate, noting that under some legal frameworks it may be possible for the trustee to dispose of an interest before the amounts were distributed. In other cases, though, the IESBA agreed that the individual would need to be removed from the team as it would be inappropriate for the person to participate on the audit knowing that he or she would be receiving a financial interest in the audit client.

Effective Date

Ms. Rothbarth reported that the exposure draft proposed that the new provisions would become effective one year after approval of the final standard with transitional provisions in three areas:

- Provision of non-assurance services – the ED proposed expanded the restrictions related to the provision of certain non-assurance services. The transitional provision proposed providing a six month period after the effective date to complete any ongoing services that were contracted before the effective date;
- Partner rotation – the ED proposed rotation of additional individuals ("other" key audit partners and all key audit partners in firms which had previously not rotated because they had limited resources). The transitional provision proposed allowing an additional year before the rotation requirements had to apply to such individuals; and
- Entities of Significant Public Interest – the ED proposed extending the listed entity provisions to all ESPIs. The transitional provision proposed allowing an additional year before the extended provisions had to be applied to such entities.

At its October 2007 meeting, the IESBA discussed the proposal and the following points were noted:

- The effective date would need to be reconsidered in light of the revised timing of the projects because of the decision to include the output of the two independence projects in the drafting conventions exposure draft;
- Concern was expressed that there might not be sufficient time for firms to plan for the additional partner rotation that would be required;
- Respondents to the exposure draft might have assumed that "time on the clock" did not count; and
- The effective date should provide sufficient time for member bodies to follow their own due process for implementation.

Ms. Rothbarth indicated that the Task Force has re-considered the proposed effective date. The Task Force notes that while the final "post-drafting" text will not be approved by the IESBA until its December 2008 meeting, the "pre-drafting" text will be available after the meeting. The Task Force is, therefore, of the view that an effective date one year after the final document is issued, subject to the transitional provisions noted above, is appropriate. The Task Force is of the view that this effective date strikes the appropriate balance between providing sufficient time for implementation and ensuring the new requirements are in effect before too much time has passed.

The IESBA discussed the proposal and the following points were noted:

- Many member bodies have a specific due process that needs to be followed and one year might not provide enough time;
- It was important not to have too long an effective date because it might encourage procrastination;

- While jurisdictions could work on changes from the "pre-drafting" version, for those jurisdictions who needed to translate the document it would be difficult because of changes such as "should" to "shall" and the changes from "consider" to "evaluate" or "determine";
- The longer the period before an effective date the less the need for transitional provisions.

After discussion, the IESBA concluded that an effective date of approximately 18 months after approval with no transitional provisions would likely strike the right balance.

Ms Munro confirmed that due process had been followed in the development of the proposed changes. Subject to the changes discussed, reviewed and agreed to at the meeting, the Board unanimously approved the document. The Board assessed that there had not been substantial change to the document that would warrant re-exposure. Mr. George thanked the Task Force and, in particular the Chair Ms Rothbarth, for all their work.

Ms. Munro indicated that the Basis for Conclusions would be circulated to IESBA members following the meeting for their comments.

3. Drafting Conventions

Mr. Dakdduk, Drafting Conventions Task Force Chair, reported that since the October IESBA meeting the Task Force had met once, and held one conference call to develop the material that was presented at the meeting. He indicated that the Task Force had considered and was presenting its recommendations on:

- Implications of the IAASB Clarity project on the Code;
- The use of the term "clearly insignificant" and its implications on the Code including the documentation requirements in Sections 290 and 291;
- The use of the word "consider";
- Use of the words "examples" and "illustrates"; and
- How threats should be described in the Code.

He noted that the Task Force's mandate was to not create additional requirements and he was of the view that the Task Force had been faithful to this mandate.

IAASB Clarity Project

Mr. Dakdduk noted that the IAASB Clarity project has adopted four conventions:

- Each ISA will state the objective to be achieved in relation to the subject matter of the ISA;
- Each ISA will specify requirements designed to achieve the stated objective. The requirements are to be applied in all cases, where they are relevant to the circumstances of the engagement, and are identified by the word "shall." 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;
- The present tense will no longer be used in ISAs to describe actions taken or procedures performed by the professional accountant;
- Each ISA will contain application material that provides further explanation and guidance supporting proper application of the standards. While the professional accountant has a responsibility to consider the entire text of a standard in carrying out an engagement the application material is not intended to impose a requirement for the professional accountant.

Mr. Dakdduk indicated that the IESBA had previously agreed that the structure of the Code and ISAs are very different. Therefore, 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. Dakdduk reported that this matter was discussed with the CAG and the CAG members agreed with the position proposed.

Mr. Dakdduk reported that the Task Force had adopted the principle of using the word "shall" to denote a requirement to comply with specific guidance (for example a fundamental principle) and also a clear prohibition. He indicated that the effect of this approach was the word "shall" frequently appears in the Code. The Task Force was of the view that the changes were appropriate - not only would the changes improve the clarity of the Code they would bring the drafting in line with the ISAs.

Clearly insignificant

Mr. Dakdduk noted that the Code 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. "Clearly insignificant" is defined in the Code as "A matter that is deemed to be both trivial and inconsequential." This construction creates the question whether an "acceptable level" is the same as "clearly insignificant." If "clearly insignificant" is a lower level than "acceptable," this would presumably mean that if a threat is not "clearly insignificant" but is at an "acceptable level" no safeguards need to be applied. In that case, there is a question of what documentation would be required if a threat was not clearly insignificant but was acceptable such that no safeguards needed to be applied.

Mr. Dakdduk reported that the Task Force proposes modifying the provisions in the Code by eliminating the references to “clearly insignificant” and providing guidance on what is intended by the term “acceptable level.” Under the proposal, 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. A professional accountant would be required to identify threats to compliance with the fundamental principles, evaluate the significance of the threats and, when necessary, identify and apply safeguards to eliminate the threats or reduce them to an acceptable level. This proposal emphasizes the importance of the accountant focusing analysis on the threats that are not at an acceptable level because those are the threats that would require the application of safeguards. The Task Force is of the view that this would be a more efficient and effective way of applying the threats and safeguards framework set out in the Code and would eliminate uncertainty about the interplay between the terms "clearly insignificant" and "acceptable level" in the existing guidance.

Mr. Dakdduk reported that the Task Force proposed amending the documentation requirement in Section 290 to state:

> “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 these 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 them or reduce them to an acceptable level. “

Mr. Dakdduk noted that this paragraph had been discussed with the CAG at its December 2007 meeting and that in response to comments received, the Task Force had added “also” in the last sentence to make it clear that when threats are identified that required the application of safeguards, additional documentation is required.

Consider, evaluate or determine

Mr. Dakdduk reported that the Code frequently uses the words “consider” or “consideration.” In reviewing the Code for clarity, the Task Force 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 Task Force recommends 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”; and
- “Determine” will be used when the accountant has to conclude and make a decision.

Examples vs Illustrates

Mr. Dakdduk noted that in certain parts of the Code (e.g., paragraph 290.6 of the ED), paragraphs 290.100 and onwards are referred to as “examples of how the conceptual approach to independence is applied . . .” The Task Force is of the view that because paragraphs 290.100 and onward are referred to as "examples," this might give the unintended message that those paragraphs are not authoritative. The Task Force notes that these paragraphs contain clear prohibitions that must be complied with. The Task Force, therefore, proposes that those paragraphs not be referred to as "examples."

Threats

Mr. Dakdduk reported that at its October 2007 meeting, the IESBA noted that the Code is not clear in how it describes threats. In some cases, it states that a particular relationship *may* create a threat and then states that the significance of *the* threat should be evaluated. It was noted that if a matter *may* create a threat, it would be more logical to then determine whether a threat is created and require the significance of *the* threat to be evaluated. In addition, in some instances, the Code states that a particular matter may create a threat, but in the view of some IESBA members the particular matter does create a threat and, therefore, stating that a threat may be created in those situations is not correct and potentially weakens the Code.

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." The Task Force believes that to clarify when a threat is or may be created, it would be helpful to address the question of “what is a threat.” The Task Force has considered the matter and has developed the following description of a threat;

> “Threats are created by relationships or other circumstances that could compromise a professional accountant’s ability to comply with the fundamental principles.”

This proposed description would require an evaluation by the accountant in each situation in which the Code says that a given relationship or circumstance creates a threat. That evaluation would center on the significance of the threat and whether the relationship or circumstance that *could* compromise the accountant's ability to comply with the fundamental principles actually *would* compromise his or her ability.

The IESBA discussed the proposal and the following points were made:

- The description of a threat was not a definition and it might be better to incorporate the idea that threats are incentives to compromise compliance with the fundamental principles;
- With the proposed description it was logical that many of the circumstances in the Code would create a threat;
- A threat could exist even when the professional accountant has complied with the fundamental principles;
- Whether the proposed description inappropriately put some of the analysis into the description – for example, in determining whether a financial interest created

a threat you would need to know the nature of the financial interest (direct or indirect) and whether it was material;
- Whether it was necessary to provide a description of a threat or whether the dictionary definition was sufficient; and
- Providing more guidance would help those who were interpreting the word differently.

After discussion, the IESBA agreed that it would be useful to have description of a threat in the Code. It was suggested that the Task Force consider the following wording:

> "Relationships or other circumstances that could provide an incentive for a professional accountant not to comply with the fundamental principles and could otherwise compromise a professional accountants' compliance with the fundamental principles."

Mr. Dakdduk reported that the Task Force had considered the description of the five categories of threat and was of the view that they could be clarified. He indicated that the Task Force proposed the following definitions:

(a) Self-interest threat - the threat that a professional accountant will act in his or her own best interest, or in the best interest of a member of his or her immediate or **close family**[*], because of a potential benefit from a financial interest in or other relationship with a client or employer ;

(b) Self-review threat - the threat that a professional accountant will not appropriately re-evaluate the results of a previous service that he or she will rely upon in forming a judgment as part of providing a current service because he or she, or others within his or her firm or organization, performed the previous service;

(c) Advocacy threat - the threat that a professional accountant who promotes a client's or employer's position may do so to the point that his or her objectivity is compromised;

(d) Familiarity threat - the threat that a professional accountant will become too sympathetic to the interests of a client or employer or will not appropriately evaluate work performed by the client or employer because the work (i) involves issues that are familiar to the professional accountant or (ii) was performed by an individual familiar to the professional accountant; and

(e) Intimidation threat - the threat that a professional accountant will subordinate his or her judgment to that of a client or employer because of their reputation or because of their attempts to exercise excessive influence over him or her.

[*] See Definitions.

The IEBSA discussed the proposals and the following points were noted:

- A self-interest threat can be created by circumstances such as fear of losing a client and it was, therefore, appropriate to expand the definition;
- While it could be argued that the changes proposed were beyond the remit of the Task Force, the description of the threats is so fundamental to the Code if improvements could be made the Task Force should be permitted to work on the wording;
- The description of the self-interest threat would be improved if the concept of "inappropriate behavior" was added;
- The description of advocacy threat could be seen as circular and the construction "may do so" is not consistent with the other threats;

The IESBA asked the Task Force to consider these matters.

4. Independence II

Mr. Winetroub, Independence II Task Force Chair, reported that the comment period on this project had ended on October 15, 2007. The Task Force met on December 3, 2007 to discuss the comments received and develop proposed changes for the consideration of the IESBA. The Task Force also held conference calls on January 9 and 11, 2008 to discuss a response letter which was received after the December Task Force meeting.

Mr. Winetroub reported that existing Section 290 states that a self-review threat may be created when a firm provides internal audit services to an audit client. It also states that a firm should not provide any internal audit services to an audit client unless the client takes certain specified actions and the findings and recommendations resulting from the internal audit activities are reported appropriately to those charged with governance. The exposure draft proposed amending the guidance of internal audit services to clarify the wide range of services that comprise internal audit services. The exposure draft 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. The exposure draft 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. The proposed changes, therefore, stated that before accepting such an engagement the firm should be satisfied that the client has designated appropriate resources to the activity. The exposure draft also indicated that, to ensure the firm does not perform management functions, the firm should only provide assistance to an audit client's internal audit function if specified conditions are in place, including that 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 (16 respondents) or implicitly (21 respondents) agreed with the proposal to permit the provision of internal audit services provided that certain specified conditions are met, Seven respondents were not supportive of the overall approach with one respondent stating that the proposed safeguards were not sufficiently robust and the Code should explain why it was acceptable to provide interest audit services to a public interest audit client.

Mr. Winetroub stated that the Task Force had considered these comments and was proposing changes to:

- Provide a fuller description of internal audit services that was consistent with ISA 610 "The Auditor's Consideration of the Internal Audit Function"; and
- State that if the firm performs internal audit services for an audit client, and it intends to use that work in the course of the external audit, the adequacy of the internal audit work should be evaluated and that the procedures performed should be no less rigorous than procedures required if the services were performed by individuals who are not members of the firm. In addition, individuals who perform internal audit activities should not be given audit responsibility for any internal audit activity with which they were involved as part of performing the internal audit services (which is consistent with the position taken in temporary staff assignments).

The IESBA discussed the proposals and the following points were noted:

- Whether the review of the work by an accountant from within the firm was sufficiently robust to address the threat in the case of an audit client that was a public interest entity;
- In some jurisdictions there are benefits for audit clients that are not public interest entities to have internal audit work performed by an external auditor. Restricting individuals who perform internal audit activities from having an external audit responsibility for any internal audit activity they performed may restrict small firms from providing such services;
- For the large part, the regulators that responded to the exposure draft expressed the view that the proposals were not sufficiently robust;
- Whether convergence would be aided if the Code was more restrictive for audit clients that were public interest entities.

After further debate, the IESBA concluded that there should be a more restrictive position for public interest entities and directed the Task Force to develop an appropriate prohibition.

Fees Relative Size

Mr. Winetroub reported 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 Task Force has considered the comments and is of the view that a fixed threshold percentage is necessary to ensure consistent application. The Task Force 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 Task Force had 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 should 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.

The IESBA discussed the proposals it was noted that, in some jurisdictions, requiring a pre or post-issuance review for the second audit opinion, and subsequent audit opinions, could be problematic because of resources.

After discussion, the IESBA agreed with the approach taken by the Task Force.

It was noted that one respondent expressed the view that the Code should be strengthened with respect to regarding the threat created when fees from a client that represent a large proportion of the revenue from an individual partner or office. The IESBA discussed the point and directed the Task Force to develop such additional guidance.

Contingent Fees
Mr. Winetroub reported 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.

He reported that the Task Force considered these comments and is of the view that a contingent fee charged by a network firm for a non-assurance service would create an unacceptable self-interest threat if the fee was material to the firm expressing the opinion on the financial statements.

The IESBA discussed the proposals and the following points were noted:
- It would be clearer to refer to contingent fees that were charged directly or indirectly;
- The definition of contingent fee had been changed from the existing Code and needed to be reviewed;
- The wording of 290.219(c) was not clear; and
- Whether there would be too significant threat is a network firm charged a contingent fee and the fee was material to the network firm.

The IESBA asked the Task Force to consider the above matters.

5. Comments from the PIOB
Mr. Schilder addressed the IESBA. He complimented the IESBA on the content and professionalism of the discussion of issues. He noted that Ethics is vital to the profession and was pleased to witness the level of debate.

He noted that he was pleased that Mr. George had reminded IESBA members of the points that had been made by the PIOB at the October 2007 IESBA meeting. He noted that almost everyone had participated in the discussion and he was of the view that the input from the technical advisors was at the right level.

Mr. Bracchi addressed the IESBA. He indicated that he was pleased with the discussion and, in particular, the discussion on internal audit services. He indicated that the

discussion on drafting conventions was very important because what might for some be only a change in language could, for others, be a change in substance. He cautioned the IESBA to ensure that the rationale for proposed changes would be clear to readers.

He noted that the PIOB was considering how to follow PIAC's processes as standards were developed. At the moment PIOB representatives attend each PIAC meeting but there is a lot of development between meetings at, for example, Task Force meetings. He indicated that the PIOB was thinking about getting specific input from each PIAC's CAG. In addition, the PIOB might consider looking at how a particular exposure draft comment had been addressed.

6. Closing

Mr. George thanked NIVRA for hosting the meeting and all members and technical advisors for their participation.

8. Future Meeting Dates

April 15-17, 2008 (New York, USA)
June 24-26, 2008 (Brussels, Europe)
October 21-23, 2008 (TBD, China)
December 2008 (TBD)