



**INTERNATIONAL FEDERATION
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Agenda Item

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Task Force Ethics Consultative Advisory Group

Meeting Location: JW Marriott, Dubai, UAE

Meeting Date: March 11, 2009

**Independence II
Report Back**

Objective of Agenda Item

To provide CAG members with an update on changes made to the Independence II project.

Background

In May 2008, the IESBA issued a re-exposure draft requesting comment on only three specific areas:

- The proposed restriction on providing internal audit services to public interest audit clients;
- Whether there should be an exception for immaterial internal audit services; and
- The required frequency of the application of the pre- or post-issuance review safeguard and the requirement to determine whether a pre-issuance review is required when total fees significantly exceed 15%.

The CAG discussed the Task Force's proposals to address comments received on exposure at its November 2008 meeting. The Task Force revised the document to address comments from CAG members and the IESBA approved the final document at its December 2008 meeting.

Discussion

Internal Audit

The majority of respondents were supportive of the proposed restriction on providing internal audit services to audit clients that are public interest entities. Respondents also expressed the view that there should not be an exception for non-recurring internal audit services.

In discussing the proposed language, a CAG member expressed the view that the prohibition on internal audit services should refer to services that are separately or in the aggregate material or significant. The IESBA considered this comment and agreed that this would clarify the prohibition. The IESBA, therefore approved the following text:

“In the case of an audit client that is a public interest entity, a firm should not provide internal audit services that relate to:

- (a) A significant part of the internal controls over financial reporting, or
- (b) Financial accounting systems that generate information that is, separately or in the aggregate, significant to the client’s accounting records or financial statements on which the firm will express an opinion; or
- (c) Amounts or disclosures that are, separately or in the aggregate, material to the financial statements on which the firm will express an opinion.”

Fees

The majority of the respondents were supportive of the proposed requirement for a pre- or post-issuance review each year after total fees from an audit client exceed 15% of the fees of the firm signing the audit opinion.

In discussing the proposed language, a CAG member expressed the view that it would be useful to reverse the order in which the safeguards are mentioned. This would put the safeguards in their chronological order and would also emphasize the stronger safeguard, the pre-issuance review. Another CAG member expressed the view that it should be clear that from the drafting that the pre- or post-issuance review is applied to the second year’s audit.

The IESBA considered these comments and agreed that this would be an improvement. The IESBA, therefore, approved the following text:

“In the case of an audit client that is a public interest entity when, for two consecutive years, the total fees from the client and its related entities (subject to the considerations in paragraph 290.24) 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 would be too significant unless the firm discloses to those charged with governance of the audit client the fact that the total of such fees represents more than 15% of the total fees received by the firm, discusses which of the safeguards below it will apply to reduce the threat to an acceptable level, and applies the selected safeguard:

- Prior to the issuance of the audit opinion on the second year’s financial statements, 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 of that engagement or a professional regulatory body performs a review of that engagement that is equivalent to an engagement quality control review (“a pre-issuance review”); or
- After the audit opinion on the second year’s financial statements has been issued, and before the issuance of the audit opinion on the third year’s financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements of the client, or

a professional regulatory body performs a review of the second year's audit that is equivalent to an engagement quality control review ("a post-issuance review").

When the total fees significantly exceed 15%, the firm should determine whether the significance of the threat is such that a post-issuance review would not reduce the threat to an acceptable level and, therefore, a pre-issuance review is required. In such circumstances a pre-issuance review should be performed.

Thereafter, when the fees continue to exceed 15%, each year, the disclosure to and discussion with those charged with governance should occur and one of the above safeguards should be applied. If the fees significantly exceed 15%, the firm should determine whether the significance of the threat is such that a post-issuance review would not reduce the threat to an acceptable level and, therefore, a pre-issuance review is required. In such circumstances a pre-issuance review should be performed."