



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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**Agenda Item
3**

Board International Ethics Standards Board for Accountants
Meeting Location: Sofitel (February 20) AICPA (February 21-22), New York, United States
Meeting Date: February 20-23, 2006

Independence

Objectives of Agenda Item

1. To provide feedback to the Task Force on the recommendations and illustrative wording presented.

Background

At its September 2004 meeting, the Ethics Committee (now IESBA) approved a project to consider whether any parts of the independence section should be revised.

The independence provisions in the Code were issued in November 2001 with an effective date for assurance reports issued after December 31, 2004. Since issuance, several failures have led to a loss in credibility in aspects of the financial reporting process and many jurisdictions have taken steps to restore credibility. Some of these steps have related to auditor independence requirements. Therefore, the IESBA concluded that it was appropriate to consider whether any parts of the independence requirements should be revisited.

The Task Force¹ first met in December 2004 and has developed some proposed wording which the IESBA has reviewed at its meetings in June and October 2005.

A public forum was held with the October 2005 meeting. One of the main objectives of the Forum was to solicit feedback on the independence project. Agenda Paper 3-A provides a summary of comments made at the forum.

After the forum, the IESBA discussed the way forward for the independence project and concluded that it was important to “bench mark” the existing Section 290 against other jurisdictions and to re-examine some of the positions taken.

¹ Jean Rothbarth (chair), Tony Bromell, Ken Dakdduk, Jean-Luc Doyle, Geoff Hopper, Peter Hughes, Thierry Karcher, Neil Lerner, Michael Niehues, Andrew Pinkney, Volker Rohricht

Since the October meeting, the Task Force has held two meetings and one conference call. It has developed several position papers, some of which are presented in these agenda papers. These position papers, where appropriate, include an analysis of positions taken in other jurisdictions and an explanation of the reasoning of the Task Force with either a suggested recommendation or specific questions soliciting the input of the IESBA. In many cases illustrative wording is presented. This wording has been developed by the Task Force to further its thinking – while the Task Force would welcome overall comments on the wording, it will not be asking for a detailed review or approval of the wording at this time. The Task Force recognizes that the wording will need to be refined – in particular to address input received from the IESBA.

Direction Given

The IESBA has already provided significant direction to the Task Force. These items are presented below for the information of new members of the IESBA and as a reminder for continuing members. The Task Force will act on this direction as it starts to redraft Section 290.

Structure of Section

IESBA has agreed that Section 290 should be restructured to deal separately with financial statements audit engagements and other assurances engagements. This decision was confirmed by forum participants who noted that the Code would be clearer if there was a standalone section dealing with independence requirements for financial statement audit clients and another standalone section addressing other assurance engagements.

User Friendly Guide

IESBA has agreed that it would be useful to issue a “user friendly” guide to independence when the final changes to Section 290 are released.

Discussion with the Audit Committee

IESBA considered whether discussing a matter with the audit committee was a safeguard that could reduce a specific threat to independence. IESBA noted that it could be argued that, if the threat is to independence in appearance, discussion with the audit committee is an effective safeguard if the audit committee agrees that the safeguards applied adequately address the threat. On the other hand some will argue that discussing a threat cannot in itself reduce the threat.

IESBA was of the view that communication with the audit committee was important because it enables the audit committee to consider the judgments made by the firm and can be helpful, particularly with respect to intimidation and familiarity threats.

On balance, the IESBA concluded that the Code should not identify communication with the audit committee as a safeguard but it should state the importance of such communications.

Directness of language

IESBA has agreed that the revised Section 290 should be written in a more direct manner. For example, Section 290 generally expresses restrictions in the following manner:

“...the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, disposal of the financial interest would be the only action appropriate to perform the engagement.” (290.12).

In other instances a restriction is described differently. For example 290.184 dealing with internal audit states that:

“Safeguards that should be applied in all circumstances to reduce any threats created to an acceptable level include ensuring that:

- The audit client is responsible for internal audit activities and acknowledges its responsibility for establishing, maintaining and monitoring the system of internal controls,
- The audit client designates a competent employee, preferably within senior management to be responsible for internal audit activities; ...and
- The findings and recommendations resulting from the internal audit activities are reported appropriately to the audit committee or supervisory body.”

Some have noted that expressing the restrictions in this manner makes it difficult for readers to identify easily what is a permitted and what is not.

While Section 290 describes restrictions as noted above, there are some instances in other sections of the revised Code where a restriction is more clearly/succinctly described. For example:

150.2 “Professional accountants should be honest and truthful and should not make exaggerated claims for services they are able to offer...”

220.6 “Where a professional accountant...has requested consent from a client to act for another party...in respect of a matter where the respective interests are in conflict and that consent has been refused by the client, then they must not continue to act for one of the parties in the matter giving rise to the conflict of interest.”

The IESBA noted that, now the conceptual framework is more established, the style of expressing the prohibitions seems to have become more direct. Accordingly, the IESBA agreed that when Section 290 is re-drafted it should be done in a more direct manner. The IESBA did, however, caution the Task Force that the restrictions should be categorized within the context of the framework and should not become a list of rules.

Discussion

Overview

The Task Force has reviewed all of Section 290 with the view to determining which areas need to be revisited. Given the length and complexity of Section 290, the Task Force has determined that an efficient way to address many of the issues is to prepare separate issues papers on each of these topics, and sometimes illustrative wording, to solicit input from the IESBA. Some of these issues papers are complete and some are still under development by the Task Force. It is also possible that as the Task Force continues its work, and obtains input from the IESBA and consults with the CAG, additional issues papers will be needed or additional topics will need to be considered.

This agenda paper provides an overview of the issues papers which the Task Force is still developing and provides a road map to the issues papers presented for discussion at this meeting.

Management Functions

The Task Force has considered whether additional guidance should be provided in Section 290 regarding the performance of management functions. Agenda Paper 3-B provides an overview of guidance in other jurisdictions, the deliberations of the Task Force and some illustrative wording.

Public Interest Entities

The Task Force has considered whether the additional auditor independence requirements that are currently applied to listed entities should be extended to public interest entities and, if so, how such entities should be defined or described. Agenda Paper 3-C contains a survey of how other jurisdictions have addressed this matter, the reasoning and recommendations of the Task Force and some illustrative wording.

Partner Rotation

The Task Force has considered the position taken in Section 290 with respect to partner rotation. Agenda Paper 3-D provides an overview of guidance in other jurisdictions, the deliberations of the Task Force and some illustrative wording.

Partner Remuneration

At the June 2005 meeting, the IESBA considered material presented by the Task Force to address a threat to independence that may be created by partner remuneration schemes and provided direction to the Task Force. Agenda Paper 3-E provides the issues considered by the Task Force and asks for the Board's direction.

Non-audit Services

At the October 2005 meeting, the IESBA directed the Task Force to benchmark the provisions regarding the provision of non-audit services in extant Section 290 with other significant jurisdictions. The Task Force has started this work and has also reviewed Section 290 to determine whether there are any additional non-audit services which

should be addressed. Agenda Paper 3-F summarizes the Task Force's work to date and its preliminary recommendations.

Bookkeeping Services

At the December 2006 IESBA Consultative Advisory Group (CAG) meeting, there was a discussion as to whether the Code struck the right balance in the area of the provision of bookkeeping services to non-listed audit clients. It was noted that as accounting standards become more complex smaller entities without a lot of accounting expertise turn to their auditors to provide assistance in this area. Agenda Paper 3-G looks at the guidance contained in other jurisdictions, the reasoning of the Task Force and some illustrative wording.

Cooling-off Period

At the June 2005 IESBA meeting, it was agreed that Section 290 should be strengthened to address the threat created by members of the firm joining the audit client. Agenda Paper 3-H looks at the guidance contained in other jurisdictions, the reasoning of the Task Force and some illustrative wording.

Restricted Use Reports

Section 290 currently provides that for restricted use reports for non-financial statement audit clients, because of the enhanced ability to communicate with users there are some differential independence requirements. Agenda Paper 3-I contains the Task Force's reasoning in this area and some illustrative wording for change.

Transaction Related Services

In reviewing the guidance on non-audit services contained in other jurisdictions, the Task Force noted that transaction services were explicitly covered in the UK APB requirements. The Task Force, therefore, considered whether additional guidance was necessary in Section 290. Agenda Paper 3-J contains the Task Force's reasoning and some illustrative wording for change.

Responsibility

A respondent to the Network Firm exposure draft noted that in some cases the Code is not clear on whether the responsibility for a particular requirement rests with the firm, an individual or all parties concerned. Agenda Paper 3-K contains examples of the how Section 290 addresses this matter and how the respondent (APB) has addressed the matter.

Complication and Agreed Upon Procedures Engagements

Section 290 establishes independence requirements for assurance engagements. The international standards for compilation and agreed upon procedures engagements (neither of which are assurance standards) require disclosure if the professional accountant is not independent. The Code contains no guidance on the standard against which such independence, or lack thereof, should be assessed. Agenda Paper 3-L outlines the issue and asked for the Board's direction.

Other Matters

In addition to matters dealing with non-audit services (as outlined in Agenda 3-F), the Task Force has identified other matters for which it is developing, or will develop, recommendations for the consideration of the IESBA at the next meeting. These matters are noted below for the information of the IESBA. If time permits, at the New York meeting the Task Force may raise some of the issues associated with these topics with a view to obtaining the preliminary input of the IESBA. The Task Force also recognizes that as it continues with its work there may be other matters that it will need to bring to the IESBA for consideration.

- *Financial interests as trustee* – The Task Force has noticed that there is an apparent anomaly in the Code in how it addresses financial interests held as a trustee – for example it considers the firm as a corporate trustee and members of the assurance team as trustee but does not consider other members of the firm as trustee.
- *Related entities* – The definition of financial statement audit client states that “when the client is a listed entity, financial statement audit client will always include its related entities”. The implication is that for listed entity audit clients, whenever the Code contains a restriction that applies to a financial statement audit client that restriction will also apply to all its related entities. The definition of a related entity includes “upstream entities” e.g. the parent of the audit client and “sister entities” e.g. an entity under common control with the client. The Task Force is of the view that in some cases the drafting of Section 290 might be unclear or inappropriately broad – for example it could be interpreted as restricting the provision of bookkeeping services to the parent of the audit client. The Task Force plans to review all references to listed entities and ensure that references to related entities are appropriate.
- *Control/significant influence* – The meanings of control and significant influence, as they are used in the related entity definition, are not defined. The Task Force notes that this could lead to inconsistent application of the Code and is therefore developing additional guidance in this area.
- *Mutual funds* – The Code does not explicitly address mutual funds. The Task Force will be considering whether it is appropriate for the Code to contain some guidance.
- *Indemnification* – The SEC regulation provide that independence is impaired if a firm enters into an agreement of indemnity which seeks to provide the accountant immunity from liability for her or his negligent acts. This matter was also raised by a CAG member. The Task Force will consider this issue.

Material Presented

Agenda Paper 3	This Agenda Paper
Agenda Paper 3-A	Forum – Summary Comments
Agenda Paper 3-B	Management Functions
Agenda Paper 3-C	Public Interest Entities
Agenda Paper 3-D	Partner Rotation
Agenda Paper 3-E	Partner Compensation
Agenda Paper 3-F	Non-audit services
Agenda Paper 3-G	Bookkeeping services
Agenda Paper 3-H	Cooling off period
Agenda Paper 3-I	Restricted Use Reports
Agenda Paper 3-J	Transaction Related Services
Agenda Paper 3-K	Responsibility
Agenda Paper 3-L	Compilation and Agreed Upon Procedures Engagements

Action requested

1. Members are asked to consider the questions noted in this agenda paper and the sub-agenda papers.