

**Minutes of the Meeting of the  
International Ethics Standards Board for Accountants  
Held on March 6-7, 2007  
New York, United States of America**

	<b>Members</b>	<b>Technical Advisors</b>
<i>Present:</i>	Richard George (chair)	
	Frank Attwood	Neil Lerner (Day 1 only)
	Margaret Butler	Bill Cordes
	Ken Dakdduk	Lisa Snyder
	David Devlin	Andrew Pinkney
	Geoffrey Hopper	Sylvie Soulier
	Kariem Hoosain	
	Lady Barbara Judge	
	Thierry Karcher	Jean-Luc Doyle
	Michael Niehues	Petra Gunia
	Luca Savino	
	Carmen Rodriguez	
	Jean Rothbarth	
		Tim Volkmann
	Robert Rutherford	David Hastings
	David Winetroub	Peter Hughes

*Regrets:* Akira Hattori  
Barbara Majoor  
Volker Röhricht

**Non-Voting Observers**

*Present:* Richard Fleck  
Bella Rivshin

**PIOB**

*Present* Michael Hafeman (Day 2 only)

**Guests**

Peter Gregory

Agenda Item 3 only

**IFAC Technical Staff**

*Present:* Jan Munro

**1. Introduction and Administrative Matters**

Mr. George opened the meeting and welcomed all those attending. He noted that apologies had been received from Ms Majoor and Mr. Hattori who had given their proxies to Mr. George and from Dr. Rohricht who had given his proxy to Mr. Volkmann.

He welcomed new members Margaret Butler and her technical advisor Bill Cordes, Lady Barbara Judge, Kariem Hoosain, Luca Savino and Carmen Rodriguez. He also welcomed Bella Rivshin as a public observer and Petra Gunia as technical advisor to Michael Niehues. On the second day he welcomed Michael Hafeman IOB member.

*Minutes of the Previous Meeting*

The minutes of the public session of the December 2006, IESBA meeting were approved as presented.

*Network Firms*

Mr. George reported that there had been further communication with the Head of the Auditing Department of the European Commission to discuss the network firm standard and steps which could be taken to encourage consistent application of the definition. Mr. Attwood and Ms Munro had met again with Mr. Tiedje to discuss some examples which had been developed to illustrate the application of network firm definition contained in the Code. The examples, which reflect the guidance contained in the body of the Code, have been provided to Mr. Tiedje who will use them in his upcoming discussions with member states. Ms Munro indicated that others might be interested in the paper and therefore she was proposing posting it as a staff document on the website. It was agreed that the document would be circulated to the Board prior to it being posted on the website.

*Planning Committee*

Mr. George reported that the Planning Committee met on February 6, 2007 to discuss and develop the draft strategic and operational plan which was included as Agenda Item 2 at the meeting. He indicated that the Planning Committee members were Mr. George, Mr. Attwood, Mr. Devlin, Mr. Fleck, Mr. Hopper, Dr. Rohricht and Ms Rothbarth.

He noted that a decision summary from the December 2006 Planning Committee meeting had been prepared and was included in Agenda Paper 1-B. A Decision Summary for the

February 2007 Planning Committee had not been prepared because the matters discussed were all addressed in Agenda Item 2 of the meeting dealing with the draft IESBA Operating and Strategic Plan.

#### *Monitoring Group*

Mr. George reported that he had made a presentation to the IFAC Monitoring Group in February 2007. The presentation had focused on the proposed changes to independence requirements that were exposed in December 2006.

#### *IFAC Board*

Mr. George indicated that he had presented to the IFAC Board on the proposed changes to independence requirements contained in the December 2006 Exposure Draft. Some IFAC Board members had indicated that members of their member bodies had some concerns with the proposals. In particular concern was expressed about:

- The impact of the elimination of the flexibility of small firms to apply alternative safeguards to partner rotation to address the familiarity threat; and
- The impact of extending all of the listed entity provisions to all entities of significant public interest.

Mr. George also reported that some IFAC Board members questioned whether IESBA had conducted any form of impact analysis. The IESBA discussed this point and the following points were noted:

- A form of impact assessment would be useful because it would enable the IESBA to respond to anticipated comments on exposure;
- The IESBA members do not have the skill set to perform such as assessment and would therefore need to solicit assistance in this area;
- It would be useful to seek the views of the PIOB to see whether they are of the view that this is something which the IESBA should take into account;
- Input from the CAG should also be sought because it is likely they would have views on this subject;
- It will be particularly difficult to perform an impact assessment for a global standard – especially when the standard is based on a conceptual framework;
- The assessment could focus on a few specific issues such as the provision of non-audit services and the impact of the changes in partner rotation.

After discussion it was agreed that while the associated difficulties were recognized the Board would explore this issue a little further. It was agreed that a small group of Board members would examine the issue. It was also agreed that consideration would be given to liaising with the other standard setting board of IFAC.

#### *PIOB*

Mr. George reported that he had made a presentation to the PIOB. The presentation addressed the IESBA plans for developing the operational and strategic plan, current projects and outreach activities since his previous report in September 2006. He reported that in response to a PIOB question whether it was possible to have an approved

operational and strategic plan by the end of 2007, he had indicated that while he recognized this was ambitious he felt that it was an appropriate goal.

#### *2008 Meeting Dates*

The following meeting dates and locations for 2008 were tentatively proposed:

- January 14-16, 2008 (TBD)
- April 15-17, 2008 (New York)
- July 8-9, 2008 (TBD)
- October 21-23, 2008 (TBD)

Certain Board members indicated conflicts with some of the dates. It was agreed that Board members would communicate any conflicts to Ms Munro and once these had been reviewed, revised finalized dates would be sent to Board members.

## **2. Operational and Strategic Plan**

Mr. George introduced the discussion of the Operating and Strategic Plan. He notes that the existing strategic plan runs to December 31, 2007. He further noted that IFAC had an agreed process for development of the strategic plans of the Public Interest Activity Committees (PIAC). The agreed process includes the following steps:

- Once every two years each PIAC shall perform a formal survey of its key stakeholders about issues that they believe should be addressed by the PIAC in the immediate future as part of its consideration of strategic priorities;
- A draft Strategic Plan and a twelve month work program shall be developed based on the results of the survey;
- The PIAC shall expose the draft Strategic Plan and work program for public comment for a period no less than 30 days;
- The PIAC shall consider the results of the exposure in formulating, as necessary, a revised Strategic Plan and twelve month work program; and
- In the first year of the two year Strategic Plan, the PIAC shall determine, in consultation with its CAG, its subsequent twelve month work program.

Mr. George reported that the Planning Committee met before the December 2006 IESBA meeting and again on February 6, 2007 to discuss:

- The existing IESBA Work Plan and timetable for completion;
- The content of a survey to IESBA stakeholders; and
- A first draft of a Strategic and Operational Plan.

The Planning Committee also considered an agenda paper outlining matters on the work plans of selected IFAC member bodies or other ethical standard setters and matters addressed in the standards of such bodies that are not currently addressed in the Code.

Mr. George presented the draft Strategic and Operational Plan contained in Agenda Paper 2-A. He noted that Appendix 1 contained the work plan for the completion of the existing

projects on the IESBA agenda and Appendix 2 would be populated with a proposed work plan once the results of the survey had been considered.

The Board discussed the Appendix 1 and the following comments were noted:

- It would be useful to provide a short description of the scope of each project;
- The Appendix proposes that the issuance of Independence 1 be delayed for six months so that it can be issued at the same time as Independence 2. It would be preferable to speed up issuance of Independence 2 such that Independence 1 did not have to be delayed and both could be issued at the same time;
- There was a strong desire to have Independence 1 issued in final form before June 2008;
- It may be possible to have the same effective dates for Independence 1 and 2 which would mean that member bodies could affect one round of changes as opposed to two.
- The project described as “Conform language in Code to IAASB language” needs to be more fully described.

The Board discussed the implications of the IAASB Clarity project on the Code. It was noted that the IAASB Clarity project had 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 which 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.

It was noted that the structure of the Code was very different from the structure of the ISAs. Therefore, the drafting convention of stating the objective for each element and separating the requirements and the application guidance were not particularly helpful for the Code. The Planning Committee had reviewed a section of the Code which had been re-drafted using all of the IAASB Clarity conventions and did not find the result an improvement in the clarity of the section. The Planning Committee was, however, of the view that the use of the word “shall” to denote a requirement was something which should be considered by the IESBA. It was agreed that a small Task Force would be formed to address this issue.

Mr. George presented the draft survey of stakeholders which had been developed by the Planning Committee. The Board discussed the survey and the following points were noted:

- Survey respondents should be asked to identify themselves i.e. this should not be optional;
- The survey should first deal with activities to achieve the IESBA objective, then the stakeholders and then the existing and future projects;
- The possible future projects should be presented as examples of possible future projects which the IESBA might undertake as opposed to projects which the IESBA believes should be undertaken;
- The possible project on mutual funds should be amended to refer to independence issues associated with audit clients that are mutual funds and the description of the possible future project on independence issues associated with compilation and agreed upon procedures engagements should be edited.

Subject to these changes and some other editorial matters the Board agreed with the content of the survey. Ms Munro noted that the survey would be placed on the IFAC website and an email notification would be sent to the list of participants noted in Agenda Paper 2. Board members agreed to provide Ms Munro with names and contact details of any additional people who should receive the survey.

### **3. Accountants in Government**

Mr. Attwood, Chair Accountants in Government Task Force and Mr. Gregory, Member Accountants in Government Task Force made a presentation to the Board on the activities of the Task Force.

Mr. Attwood explained that the Task Force had been formed to consider the changes to the Code which might be appropriate to more explicitly address accountants in government. As currently drafted, Part B applies to professional accountants in public practice and Part C applies to professional accountants in business (which include professional accountants in government). However it is not clear how or whether Part B applies to professional accountants in government who perform assurance engagements. Also there is no specific guidance in Part C for professional accountants in government.

Mr. Gregory provided the Board with an overview of the nature of assurance engagements performed in the public sector. He indicated that the audits of the financial statements of government organizations and other assurance engagements in these organizations are usually undertaken by a combination of government auditors (often called Auditors General or State Auditors) with a mandate from an elected body and private sector firms. The national or state accounts are usually audited by the government auditor but other government agencies (such as health, educational and social services) and municipalities are often audited by private sector firms. He estimated that in his country, Canada, the split of probably 50:50.

Mr. Gregory reported that auditing and assurance standards established by the International Auditing and Assurance Standards Board (IAASB) are applicable to

engagements in the public sector. For standards which were issued after January 2005 when additional guidance is appropriate for the public sector, such guidance is provided in the body of the standard, standards issued prior to this date contained where necessary a separate “Public Sector Perspective” providing additional guidance for the public sector. The IAASB and the Professional Standards Committee (PSC) of the International Organization of Supreme Audit Institutions have signed a memorandum of understanding which allows the PSC to use the International Standards on Auditing as the basis for guidelines on public sector financial audits.

Mr. Gregory further reported that the similarity between private sector firms and government auditors extends to the way government auditors organize themselves. For example Section 210 addressing Professional Appointment is equally relevant for government auditors as is Section 220 on Conflicts of Interest.

Mr. Gregory reported that the Task Force had reviewed the Code and is of the view that as drafted the Code is largely appropriate for professional accountants in government. It is of the view that there are a few specific areas where an addition would make the Code more inclusive and directly relevant to professional accountants in government. The changes that the Task Force will be recommending do not require different principles rather they will suggest the expansion of some guidance to deal with the public sector application and context.

The Board discussed the views of the Task Force. The following points were noted:

- Without seeing the proposed wording from the Task Force it was difficult to respond to recommendations of the Task Force;
- The exposure draft of proposed revised Section 290 and proposed new Section 291 is currently drafted for public accounting firms. It is difficult to see how a few paragraphs would make it equally applicable to professional accountants in the public sector that perform assurance engagements. For example:
  - The proposals require partner rotation for entities of significant public interest, in many jurisdictions the audit general is required by legislation to sign the audit reports; and
  - Government auditors are employed by the government – which is technically the audit client.
- One of the reasons for splitting Section 290 into two sections was to have one section which applied audit of financial statements – which are the majority of assurance engagements. It would be unfortunate if the additional paragraphs proposed by the Task Force made Section 290 a more difficult read by firms performing audit engagements.

After discussion it was agreed that the Task Force would consider the points raised by the Board in developing a way forward.

#### **4. Independence Part II**

Mr. Winetroub, Chair Independence II Task Force, presented the recommendations of the Independence II Task Force who had considered proposed changes to the Code to address

provision of internal audit services, contingent fees and economic dependence. He noted in developing recommendations for all three topics the Task Force had reviewed the guidance in the Code, benchmarked to other jurisdictions and considered the proposals of the December 2006 exposure draft.

#### *Internal Audit Services*

Mr. Winetroub noted that the existing guidance states that internal audit services (other than operational internal audit services unrelated to the internal accounting controls, financial systems or financial statements) create a self-review threat and the services may only be performed if five specific safeguards are applied. The existing Code also indicates that consideration should be given to whether the internal audit services should be performed by personnel who are not part of the audit team and who have different reporting lines in the firm. The Code also provides a caution that before performing a significant part of an audit client's internal audit activities the firm should consider the threats and proceed with caution.

Mr. Winetroub reported that the Task Force considered the wide range of activities which could be categorized as internal audit services. In considering the threat which could be created by such services the Task Force was of the view that distinction between internal audit services and external audit services was somewhat blurred and the same procedures could be performed as internal or external services. Accordingly, the Task Force was of the view that self-review is not the issue with respect to internal audit services, rather the issue is that any firm personnel performing internal audit activities should not perform management functions. He indicated that the Task Force was recommending that the guidance in Section 290 should contain the following with respect to internal audit services:

1. An explanation that internal audit services comprise performing audit procedures.
2. A statement that internal audit services may be provided to an audit client provided the firm does not perform management functions. Guidance would be provided on what would be considered to be a management function. This would include:
  - Designing and/or implementing internal accounting controls or controls related to the financial systems or financial statements;
  - Deciding which recommendations of the firm should be implemented;
  - Performing ongoing monitoring activities or control activities;
  - Approving the audit work plan including the scope, risk and frequency of the internal audit work; and
  - Authorizing transactions.
3. Stating that if a firm performs a significant portion of the client's internal audit activities the firm should take particular care that it does not perform management functions. The client needs to dedicate sufficient resources to the internal audit function to ensure that it performs all the management decisions.
4. A statement that it would not be acceptable to perform an activity that would otherwise be prohibited by the Code as part of an internal audit activity.

A view was expressed that because internal audit is part of the internal control of an entity, when performing an external audit there is a need to check the work of internal



audit to ensure reliance is warranted and therefore there is a self-review threat. A converse view was expressed that the need to review the internal audit work is to ensure that reliance is warranted – it is a matter for auditing standards as opposed to creating a self-review threat.

It was noted that several major stakeholders explicitly state that performing internal audit services create a self-review threat. Mr. Winetroub indicated that the Task force had considered this matter but was of the view that, absent providing assurance on internal control, performing internal audit activities did not create a self-review threat. A view was expressed that there can be a threat because if a firm performed internal audit services there may be tendency to be less rigorous in reviewing the results of that work because it was performed by firm personnel. This was countered by a view that this is no different from an audit of financial statements where reliance is placed on the work which was performed in the previous year.

After discussion it was agreed that:

- Internal audit activities comprise a wide spectrum of services from operational internal audit activities unrelated to the financial statements to activities which are integral to the monitoring of the internal control of the company;
- The threats to independence are dependent upon the nature of the internal audit service;
- The proposed guidance should aim to describe the spectrum of services and indicate which services could be provided and which could not. For example, at one end of the spectrum would be internal audit services which are an extension of external audit procedures and at the other end of the spectrum would be activities such as monitoring of controls – which would not be acceptable because this is a management function and a part of the company's internal control;
- It should be clear from the proposed guidance that personnel performing internal audit activities should not perform management functions;
- The Task Force should carefully consider whether because of the sensitivities and perception there should be a more restrictive position for entities of significant public interest;
- The IOSCO survey of non-audit services provides some useful input in this area and should be considered by the Task Force as they develop proposed wording.

#### *Contingent fees*

Mr. Winetroub noted that the existing guidance provides that a firm should not enter into a contingent fee arrangement in respect of an audit or other assurance engagement since this creates unacceptable self-interest and advocacy threats. The Code also provides that a firm should not enter into a contingent fee arrangement for a non-assurance service if the fee was contingent on the result of the audit engagement. For other types of contingent fee arrangements for non-assurance services provided to an assurance client, the Code adopts a threats and safeguards approach.

Mr. Winetroub reported that the Task Force considered the nature of the threat created by contingent fee arrangements and was of the view that performing an engagement for a

contingent fee for an audit client creates a self-interest threat in that it puts the firm in a position of wanting the same outcome as the client. The Task Force is of the view that the existing position in the Code that a firm should not enter into a contingent fee arrangement in respect of an audit or other assurance engagements continues to be appropriate. Such an arrangement would create an unacceptable self-interest threat.

The Task Force is of the view that when a firm performs a non-assurance engagement for an audit client for a contingent fee the threat would be too significant if either the fee was material to the firm or the fee related to a matter which was material to the financial statements. The Task Force, therefore, recommends that such fee arrangements should not be permitted.

The Board discussed the recommendations of the Task Force and the following points were noted:

- Whether the materiality of the contingent fee should be measured by reference to the audit fee as opposed to the revenue of the firm;
- The contingent fee for a non-assurance service might be received by a network firm as opposed to the firm that is signing the audit opinion; and
- It might be difficult at the outset of the engagement to know whether the final amount of the contingent fee was material.

After discussion it was agreed that:

- The existing definition of a contingent fee was appropriate;
- The existing restriction regarding performing an assurance engagement for a contingent fee was appropriate;
- The revised guidance should contain a restriction on contingent fees for non-assurance services provided to an assurance client if the contingent fee is material to the firm signing the audit opinion or relates to a matter which is material to the financial statements; and
- The Task Force should consider contingent fees received by network firms for the performance of non-assurance services to an audit client of the firm.

#### *Economic Dependence*

Mr. Winetroub noted that the existing guidance provides that when the total fees from an assurance client represent a large proportion of the total fees of the firm, the dependence on that client or client group and concern about losing the client may create a self-interest threat. The Code also provides that a self-interest threat may be created when the fees generated from an assurance client represent a large proportion of the revenue from an individual partner's clients.

Mr. Winetroub reported that the Task Force considered the threat created when a significant portion of the firm's total fees come from one assurance client and whether there is a specific threshold level of fees above which the threat would be so significant that safeguards could not reduce the threat to an acceptable level. The Task Force was mindful that Section 290 applies to all professional accountants performing audit and review engagements irrespective of the size of firm or the size of client. The Task Force

was also mindful of situations where an individual might have a part-time practice with only one or two small audit clients – for example performing the audits of two charities on a part-time basis.

Mr. Winetroub reported that the Task Force is of the view that the existing guidance is appropriate for entities that are not of significant public interest but is of the view there should be a more restrictive position for audit clients that are entities of significant public interest. The recommendations from the Task Force were:

- Retaining the existing guidance regarding the threat created when the total fees from an audit client represent a large proportion of the total fees of the firm expressing an audit opinion and retaining the guidance regarding the threat created when the fees generated from an audit client represent a large proportion of the revenue from an individual partner's clients;
- New guidance stating that in the case of an audit client that is an entity of significant public interest when for more than two consecutive years the total fees from that client, and its subsidiaries, received by the firm expressing the audit opinion, amount to more than 15% of the total fees of the firm, the self-interest threat to independence would generally be so significant it could not be reduced to an acceptable level unless both of the following safeguards are applied:
  - An engagement quality control review performed by a professional accountant who was not a member of the firm expressing the audit opinion (the review would be performed before the issuance of the audit opinion in the third year); and
  - Disclosure to those charged with governance that the total fees from the client and its subsidiaries represented more than 15% of the total fees of the firm.
- New guidance stating that if the audit client is an entity of significant public interest and it is a subsidiary of an entity that is not an entity of significant public interest, the firm should consider the significance of the self-interest threat created by total fees from the audit client, its subsidiaries and the parent. If the threat is other than clearly insignificant apply safeguards to eliminate the threat or reduce it to an acceptable level.

The Board discussed the recommendations of the Task Force and the following points were noted:

- A view was expressed that it was inappropriate to have a “bright-line” test of 15%. It was noted that the EU Recommendation on Auditor Independence that the threshold was stated as an “unduly high percentage” and it was left to member states to define, if necessary, what would be considered to constitute an unduly high percentage in that jurisdiction;
- A contrary view was expressed that without some form of bright line in the Code there could be a wide spectrum of opinion as to what was acceptable and what was too high;
- It might be difficult for small firms to find an accountant from outside the firm who was willing to perform the engagement quality control review;

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- Providing a bright-line threshold for all entities of significant public interest might have unintended consequences because it addresses more than listed entities;

After discussion it was agreed that:

- The Task Force should develop proposed wording which establishes a bright-line test at the 15% threshold level;
- The Task Force should consider whether there were alternative safeguards which should be applied if the threshold level was reached;
- The Task Force should consider fees received from not only subsidiaries of the audit client but also other “downstream entities” such as those over which the client has significant influence.

## **5. Closing**

Mr. George indicated that there was a lot of material for the June meeting and asked Board members whether they would be able to meet for three days instead of two. It was agreed that all Board members would confirm their availability to Ms Munro.

Mr. George thanked all for attending and their participation in the meeting.

## **6. Future Meeting Dates**

June 25-26, 2007 (Berlin)

October 23-25, 2007 (Buenos Aires)