

Introduction

This memorandum provides background to, and an explanation of, the proposed changes to the *Code of Ethics for Professional Accountants* (the Code), approved for exposure by the International Ethics Standards Board for Accountants (IESBA or the Board) in June 2007.

The IESBA welcomes comments on the proposed revisions to Section 290 and the Section 291. Comments should be received by October 15, 2007.

Background

In December 2006 the IESBA issued an exposure draft proposing revisions to existing Section 290 and a new Section 291. The comment period ended on April 30, 2007. In that exposure draft the IESBA indicated that there were three additional areas that would be considered to determine what changes are appropriate to enhance independence. This exposure draft proposes changes to address these three areas. The IESBA welcomes comments on the changes in these three areas. Comments on the remainder of Sections 290 and 291 are not being sought at this time as comments were requested in the exposure draft issued in December 2006. The comment period on that exposure draft has ended and the IESBA is considering the comment received.

Significant Proposals

Internal Audit

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 IESBA proposes amending this guidance to clarify the wide range of services that comprise internal audit services and the differing ways in which these could be conducted. The IESBA is of the view that depending on the nature of the services a threat to independence may be created. Certain services, such as the outsourcing of all or a portion of the internal audit function whereby the firm is responsible for determining the scope of the work and which recommendations should be implemented involves management functions. The IESBA is of the view that a firm should not provide such services.

The IESBA is of the view 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 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. In addition, the significance of any remaining threat should be evaluated and, if it is not clearly insignificant, safeguards should be considered and applied when necessary to eliminate the threat or reduce it to an acceptable level.

The IESBA is also of the view 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, state that before accepting such an engagement, the firm should proceed with caution and be satisfied that the client has designated appropriate resources to the activity.

The IESBA considered whether there should be a more restrictive requirement for an audit client that is an entity of significant public interest. The IESBA concluded that procedures performed as part of internal audit services and procedures performed during an audit conducted in accordance with International Standards on Auditing can be similar and that prohibiting procedures simply because there are done as part of an internal audit service is unnecessary as long as the procedures do not entail the performance by the firm of management functions. Accordingly, the IESBA is of the view that internal audit services can be provided as long as the firm does not perform management functions and eliminates or reduces to an acceptable level any remaining threat that is not clearly insignificant. Therefore, the IESBA is of the view that it is not appropriate to have a more restrictive requirement for audit clients that are entities of significant public interest.

Fees – Relative Size

The proposed revisions to Section 290 provide additional guidance with respect to the relative size of fees from an audit client that is an entity of significant public interest. The IESBA is of the view that where the total fees from such a client represent more than 15% of the total fees received by the firm signing the opinion for more than two years the self-interest threat created would be too significant unless disclosure is made to those charged with governance of the client that the fees represent more than 15% of the total fees of the firm 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 not less than once every three years; 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

The significance of the relative size of the fee should be considered in determining which of the two safeguards should be applied and, in the case of a post issuance review, whether the review should be performed more frequently than every three years.

The IESBA is of the view that the professional accountant who performs such a review may be a member of a network firm

Contingent Fees

The proposed revisions to Sections 290 and 291 provide 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 amount of the contingent fee would be material to the firm or the fee relates to a matter that is material to the client's 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 the service for a contingent fee if either the amount of the contingent fee would be material to the firm signing the audit opinion or the fee relates to a matter that is material to the client's subject matter information.

The proposed revisions also provide that a network firm that participates in the audit should not provide a non-assurance service for the audit client if the fee relates to a matter that is material to the client's consolidated financial statements.

Guide for Commentators

The IESBA welcomes comments on the proposed revisions. Comments are most helpful when they refer to specific paragraphs, include the reason for the comments and, where appropriate, make specific suggestions for any proposed changes to wording to enable the IESBA to fully appreciate the respondent's position. Where a respondent agrees with proposals in the exposure draft (especially those calling for a change in current practice), it will be helpful for the IESBA to be made aware of this view.

Request for Specific Comments

1. In the case of audit clients that are entities of significant public interest, is it appropriate to require specific safeguards, including disclosure to those charged with governance, if the total fees from that client exceed a specified percentage of the total fees of the firm? If it is appropriate to establish such a threshold, is 15% the appropriate threshold?

Comments on Other Matters

Recognizing that the proposed revised Code will apply to all professional accountants in public practice that perform assurance engagements, the IESBA is also interested in comments on matters set out below.

Special Considerations on Application in Audit of Small Entities

Respondents are asked to comment on whether, in their opinion, considerations regarding the audit of small entities have been dealt with appropriately in the proposed revisions to the Code. Reasons should be provided if not in agreement, as well as suggestions for alternative or additional guidance.

Developing Nations

The IESBA welcomes comments on any foreseeable difficulties in applying the proposed provisions in a developing nation environment. Reasons should be provided, as well as suggestions for alternative or additional guidance.

Translations

The IESBA welcomes comments from respondents on potential translation issues noted in reviewing this exposure draft.