

The following revisions are proposed to the exposure draft that was issued by the IESBA in December 2006 (“the December ED”).

## REVISION OF SECTION 290

### INDEPENDENCE – AUDIT AND REVIEW ENGAGEMENTS

*Paragraphs 290.1-290.185 of the December ED will be unchanged and paragraphs 290.186-191 will be deleted and replaced with the following paragraphs.*

#### Internal Audit Services

290.186 Internal audit functions comprise a wide range of activities, for example:

- (a) reviewing and testing of internal controls over financial reporting;
- (b) performing procedures that form part of the internal controls;
- (c) conducting operational internal audit activities unrelated to internal controls over financial reporting; and
- (d) performing fraud investigations.

290.187 Depending on the nature of the service, the provision of internal audit services to an audit client may create a threat to independence if such services involve the firm performing management functions or reviewing its own work in the course of a subsequent audit.

290.188 Assisting an audit client in the performance of a significant part of the client’s internal audit function increases the risk that firm personnel providing the internal audit service will become part of the client’s internal controls or will ~~make~~ take management decisions. Accordingly, before accepting an engagement to perform a significant part of an audit client’s internal audit functions, the firm should be satisfied that the client has designated appropriate resources to the activity to take responsibility for the matters detailed in paragraph 290.190.

290.189 If a firm performs management functions for an audit client, no safeguards could ~~eliminate reduce~~ the threats or reduce them to an acceptable level. Accordingly, a firm ~~should-shall ensure that it does~~ not perform management functions when providing internal audit services to an audit client. Examples of internal audit services that entail the performance of management functions include:

- (a) performing outsourced internal audit services, comprising 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;
- (b) performing procedures that form part of the internal controls, such as reviewing and approving changes to employee data access privileges.

290.190 To ensure that performing internal audit services does not threaten independence the firm ~~should-shall~~ only provide internal audit services to an audit client if all of the following conditions are met:

- (a) The client is responsible for internal audit activities and acknowledges its responsibility for establishing, maintaining and monitoring the internal controls;
- (b) The client designates a competent employee, preferably within senior management, to be responsible for internal audit activities;
- (c) The client or those charged with governance approve the scope, risk and frequency of internal audit work;
- (d) The client is responsible for evaluating and determining which recommendations of the firm to implement;
- (e) The client evaluates the adequacy of the internal audit procedures and the findings resulting from their performance by, among other things, obtaining and acting on reports from the firm; and
- (f) The findings and recommendations resulting from the internal audit activities are reported appropriately to those charged with governance.

290.191 Before the firm accepts an engagement to provide internal audit services to an audit client, ~~consideration the firm should~~ shall be given to evaluate the scope and objective of the proposed engagement and determine whether the work to be undertaken is expected to create a self-review threat because it is likely to be relied upon in ~~the making of~~ a significant audit judgment related to a matter that is material to the financial statements. ~~If the self-review threat is not clearly insignificant, The significance of the threat created shall be evaluated and~~ shall be evaluated and safeguards ~~should be considered and~~ applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such ~~Such~~ safeguards ~~might~~ include:

- Using professionals who are not members of the audit team to perform the internal audit services; and
- Having an additional professional accountant review the work or otherwise advise as necessary.

*Paragraphs 290.192-290.212 of the December ED will be unchanged and paragraphs 290.213-290.219 will be deleted and replaced with the following paragraphs:*

## **Fees**

### **Fees – Relative Size**

290.213 When the total fees from an audit client represent a large proportion of the total fees of the firm expressing the audit opinion, the dependence on that client and concern about losing the client may create a self-interest threat. The significance of the threat will depend on factors such as:

- The operating structure of the firm;
- Whether the firm is well established or new; and
- The significance of the client qualitatively and/or quantitatively to the firm.

The significance of the threat ~~should~~shall be evaluated and, ~~if the threat is not clearly insignificant, safeguards should be considered and~~ applied when necessary to eliminate the threat or reduce it to an acceptable level. ~~Examples of such~~ Such safeguards ~~might~~ include:

- External quality control reviews; or
- Consulting a third party, such as a professional regulatory body or another professional accountant, on key audit judgments.

290.214 A self-interest threat may also be created when the fees generated from an audit client represent a large proportion of the revenue from an individual partner's clients. The significance of the threat ~~should~~shall be evaluated and, ~~if the threat is not clearly insignificant, safeguards should be considered and~~ applied when necessary to eliminate the threat or reduce it to an acceptable level. ~~An example of such a~~ Such safeguards ~~might~~includes having an additional professional accountant review the work or otherwise advise as necessary.

#### *Audit Clients that are Entities of Significant Public Interest*

290.215 In the case of an audit client that is an entity of significant public interest 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 shall disclose 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 and apply one of the following safeguards ~~are applied~~ to the following year's audit:

- 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

Thereafter, ~~in the determining determination of~~ which of these safeguards ~~should be applied~~ and the frequency of their application, ~~will depend upon consideration should be given to~~ the extent to which the relative size of the fees from the audit client in relation to the firm's total fees is greater than 15%. At a minimum a post-issuance review ~~should~~shall be performed not less than once every three years commencing with year 3.

#### **Fees – Overdue**

290.216 A self-interest threat may be created if fees due from an audit client remain unpaid for a long time, especially if a significant part is not paid before the issue of the audit report for the following year. Generally the firm ~~should~~shall require payment of such fees

before the audit report is issued. If the fee remains unpaid after the report has been issued, the significance of the threat ~~should-shall~~ be evaluated. ~~If the threat is not clearly insignificant, and~~ safeguards ~~should-be-considered-and~~ applied when necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include having an additional professional accountant who did not take part in the audit engagement, provide advice, or review the work performed. The firm ~~should-shall~~ also ~~consider-evaluate~~ whether the overdue fees might be regarded as being equivalent to a loan to the client and whether, because of the significance of the overdue fees, it is appropriate for the firm to be re-appointed.

## Contingent Fees

290.217 **Contingent fees**\* are fees calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the work. For the purposes of this section, fees are not ~~regarded-as-being~~ contingent if a court or other public authority has established them or is required to approve them.

290.218 A contingent fee charged by a firm in respect of an audit engagement creates self-interest and advocacy threats that cannot be reduced to an acceptable level by applying any safeguard. Accordingly, a firm ~~should-shall~~ not enter into any such fee arrangement.

290.219 A contingent fee charged by a firm in respect of a non-assurance service provided to an audit client may also create self-interest and advocacy threats. No safeguards can reduce the threats to an acceptable level if the amount of the fee is either: (a) material or expected to be material to the firm expressing the opinion on the financial statements; or (b) dependent upon the outcome of a future or contemporary judgment related to the audit of a material amount in the financial statements. Accordingly, a firm shall not enter into any such arrangements ~~should-not-be-accepted~~.

290.220 For other types of contingent fee arrangements charged by a firm for a non-assurance service to an audit client, the significance of the threats will depend on factors such as:

- The range of possible fee amounts;
- The nature of the service; and
- The effect of the event or transaction on the financial statements.

The significance of the threats ~~should-shall~~ be evaluated and, ~~if the threats are not clearly insignificant,~~ safeguards ~~should-be-considered-and~~ applied when necessary to eliminate the threats or reduce them to an acceptable level. Examples of such ~~Such~~ safeguards ~~might~~ include:

- Review or determination of the final fee by an unrelated third party; or
- Quality control policies and procedures for the non-assurance service.

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\* See Definitions.

*Paragraphs 290.220-290.223 of the December ED will be unchanged and will be renumbered 290.221-290.224 respectively.*

## REVISION OF SECTION 291

### INDEPENDENCE – OTHER ASSURANCE ENGAGEMENTS

*Paragraphs 291.1-291.150 of the December ED will be unchanged and paragraphs 290.151-154 will be deleted and replaced with the following paragraphs.*

#### Contingent Fees

291.151 Contingent fees are fees calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the work. For the purposes of this section, fees are not ~~regarded as being~~ contingent if a court or other public authority has established them or is required to approve them.

291.152 A contingent fee charged by a firm in respect of an assurance engagement creates self-interest and advocacy threats that cannot be reduced to an acceptable level by applying any safeguard. Accordingly, a firm ~~should~~shall not enter into any such fee arrangement.

291.153 A contingent fee charged by a firm in respect of a non-assurance service provided to an assurance client may also create self-interest and advocacy threats. If the amount of the fee for a non-assurance engagement is dependent on the result of the assurance engagement no safeguards can reduce the threat to an acceptable level. Accordingly, such arrangements ~~should~~shall not be accepted.

291.154 For other types of contingent fee arrangements charged by a firm for a non-assurance service to an assurance client, the significance of the threats will depend on factors such as:

- The range of possible fee amounts;
- The nature of the service; and
- The effect of the event or transaction on the financial statements.

The significance of the threats ~~should~~shall be evaluated and, ~~if the threats are not clearly insignificant,~~ safeguards ~~should be considered and~~ applied when necessary to eliminate the threats or reduce them to an acceptable level. Examples of such ~~Such~~ safeguards ~~might~~ include:

- Review or determination of the final fee by an unrelated third party; or
- Quality control policies and procedures for the non-assurance service.

*Paragraphs 291.155-156 of the December ED will be unchanged.*

#### Definitions

*The definition of contingent fee in the December ED will be deleted and replaced with the following definition:*

**Contingent fee** A fee calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the work performed. A fee that is established or required to be approved by a court or other public authority is not a contingent fee.