



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

545 Fifth Avenue, 14th Floor
New York, New York 10017
Internet: <http://www.ifac.org>

Tel: +1 (212) 286-9344
Fax: +1 (212) 856-9420

Agenda Item

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Board International Ethics Standards Board for Accountants

Meeting Location: Park Plaza Victoria, Amsterdam, Netherlands

Meeting Date: January 21-23, 2008

Independence

Objectives of Agenda Item

1. To discuss and approve the “pre-drafting” changes to Section 290 and 291 resulting from the December 2006 Exposure Draft.

Background

In December 2006, the IESBA issued an exposure draft (ED) proposing revisions to existing Section 290 and proposing a new Section 291. The ED period ended on April 30, 2007.

Comments have been received from the following:

Member Bodies of IFAC	33
Firms	8
Regulators	4
Government Organizations	3
Other	28
Total Responses	76

All of the comment letters received have been posted on the IFAC website and may be downloaded at <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0075>.

At the October 2007 meeting, the IESBA received a disposition of comments received on exposure and reviewed a first draft of the proposed changes in response to the comments. The Task Force has met twice since the October 2007 IESBA meeting and has one conference call. The CAG discussed a draft of the proposals at its meeting on December 11, 2007. The Task Force considered and responded to the input of the CAG at its Task Force meeting the following day.

Issues

Public Interest Entities

At the October meeting, the IESBA discussed the proposed changes to the definition of public interest entities. The IESBA asked the Task Force to consider including additional guidance on the types of factors which would be considered. The Task Force was also asked to consider paragraph 290.24 and the definition of public interest entity because it is the audit that is subject to independence requirements as opposed to the entity.

The CAG discussed the proposed revised definition at its December 2007 meeting. A CAG member noted that he was disappointed with the definition of public interest entities and was concerned that it would only mandate that the additional requirements apply to the audit of listed entities. The CAG member noted that, as indicated in the response, the view of the Basel Committee on Banking Supervision was that public interest entities should always include regulated banks even when some of those regulated banks would not have a large and wide range of stakeholders. The fact that regulated banks accept money from the public and have a pivotal role in the economy (e.g. payments services and loans) justifies that these organizations should be considered entities of public interest.

The Task Force has considered the input from the CAG and the IESBA and is proposing the following guidance with respect to public interest entities:

290.25 In evaluating the significance of threats to independence, and the safeguards necessary to eliminate them or reduce them to an acceptable level, the extent of public interest in the entity is taken into account. This section, therefore, contains enhanced safeguards to recognize the degree of public interest in certain entities. For the purpose of this section, **public interest entities** are:

- all **listed entities**;
- any entity defined by a regulator or by legislation as a public interest entity; and
- any entity for which a regulator or legislation requires either the audit to be conducted in accordance with the auditing standards that are applicable to listed entities or the firm to comply with the ethical requirements that are applicable to the audit of listed entities.

290.26 Firms and member bodies are encouraged to consider whether additional entities should also be treated as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered include:

- The nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders. Examples may include financial institutions, such as banks and insurance companies, and pension funds;
- Size; and
- Number of employees.

The Task Force considered whether regulated banks should be included in the definition of public interest entities. The Task Force was of the view that other institutions accept money from the public – for example insurance companies, pension funds and credit unions. The Task Force was concerned that this would inappropriately expand the definition of public interest entity. The Task Force also recalled the concern expressed by many respondents to the exposure draft which indicated that public interest entities will “normally include regulated financial institutions such as banks and insurance companies”.

Taxation Services

At the October meeting, the IESBA discussed valuations performed for tax purposes. The following points were noted:

- It is not clear if the guidance under valuations should be followed or the guidance under tax services if a firm perform a tax valuation;
- It could be argued that all taxation services have at least an indirect effect on the financial statements;
- A valuation service is either primarily a valuation service or a taxation service and the facts of the service need to be examined to determine which section of the Code applies to the particular fact pattern;
- Some valuations may be directly incorporated into the financial statements while others might have only a direct effect on the financial statements; and
- It is important that any additional guidance on tax valuations is consistent with the threats created by such services.

After discussion, the IESBA concluded that tax valuations should be explicitly addressed in the Code under the taxation section. The IESBA asked the Task Force to develop such guidance for consideration at the next IESBA meeting.

The Task Force had developed the following guidance:

290.190 In providing tax services to an audit client, a firm may be requested to perform a valuation to assist the client with its tax reporting obligations or for tax planning purposes. Where the result of the valuation will have a direct effect on the financial statements, the provisions included in paragraphs 290.175 to 290.179 relating to valuation services are applicable. Where the valuation is performed for tax purposes only and the result of the valuation will not have a direct effect on the financial statements (i.e. the financial statements are only affected through accounting entries related to tax), this would not generally threaten the firm’s independence if such effect on the financial statements is immaterial or if the valuation is subject to external review by a tax authority or similar regulatory authority. If the valuation is not subject to such an external review and the effect is material to the financial statements, the significance of any threat created should be evaluated. The significance of a threat will depend upon factors such as:

- The extent to which the valuation methodology is supported by tax law or regulation, other precedent or established practice and the degree of subjectivity inherent in the valuation.
- The reliability and extent of the underlying data.

If the threat created is not clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Using professionals who are not members of the audit team to perform the service;
- Having a professional review the audit work or the result of the tax service; or
- Obtaining pre-clearance or advice from the tax authorities.

Effective Date

The IESBA discussed the proposed effective date at its October 2007 meeting. The exposure draft proposed that the new provisions would become effective one year after approval of the final standard with transitional provisions in three areas:

- Provision of non-assurance services – the ED proposed expanded some of the restrictions related to the provision of certain non-assurance services. The transitional provision proposed providing a six month period after the effective date to complete any ongoing services that were contracted before the effective date;
- Partner rotation – the ED proposed rotation of additional individuals (“other” key audit partners and all key audit partners in firms which had previously not rotated because they had limited resources). The transitional provision proposed allowing an additional year before the rotation requirements had to apply to such individuals; and
- Entities of Significant Public Interest – the ED proposed extending the listed entity provisions to all ESPIs. The transitional provision proposed allowing an additional year before the extended provisions had to be applied to such entities.

The IESBA discussed the proposal and the following points were noted:

- The effective date would need to be reconsidered in light of the revised timing of the projects because of the decision to include the output of the two independence projects in the drafting conventions exposure draft;
- Concern was expressed that there might not be sufficient time for firms to plan for the additional partner rotation that would be required;
- Respondents to the exposure draft might have assumed that “time on the clock” did not count; and
- The effective date should provide sufficient time for member bodies to follow their own due process for implementation.

The Task Force has re-considered the proposed effective date. The Task Force notes that while the final `post-drafting` text will not be approved by the IESBA until its December 2008 meeting, the `pre-drafting` text will be available after the January meeting. The Task Force is, therefore, of the view that an effective date one year after the final document is issued, subject to the transitional provisions noted above, is appropriate. The Task Force is of the view that this effective date strikes the appropriate balance between providing sufficient time for implementation and ensuring the new requirements are in effect before too much time has passed.

Consideration of re-exposure

The IESBA`s due process and working procedures states that after approving the revised content of an exposed standard the IESBA assesses whether there has been substantial change to the exposed document that may warrant re-exposure. Situations that constitute potential grounds for a decision to re-expose may include, for example, substantial change to a proposal arising from matters not aired in the exposure draft such that commentators have not had an opportunity to make their views known to the Board before it reaches a final conclusion; substantial change arising from matters not previously deliberated by the IESBA; or substantial change to the substances of a proposed international standard.

The Task Force is of the view that there has not been substantial change to the document that warrants re-exposure. The changes made are in response to the comment received.

Material Presented

Agenda Paper 2	This Agenda Paper
Agenda Paper 2-A	Proposed revised Section 290 and 291 (clean)
Agenda Paper 2-B	Proposed Revised Section 290 and 291 (mark-up)
Agenda Paper 2-C	Basis for Conclusions
Agenda Paper 2-D	Due Process Checklist

Action Requested

1. IESBA members are asked to approve the “pre-drafting” document. The affirmative vote of 12 members of the Board is necessary for approval.
2. IESBA members are asked to confirm the view of the Task Force that re-exposure is not necessary.
3. The draft Basis for Conclusions is provided for the information of IESBA members. This document is not approved by the IESBA but they are encouraged to provide any comments they might have directly to staff.