



**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: JW Marriott, San Francisco, USA

Meeting Date: February 23-25, 2009

Drafting Conventions

Objective of Agenda Item

To review the proposed changes to the exposure draft in response to comments received on exposure and to provide direction to the Task Force.

Background

In July 2008, the IESBA issued an exposure draft proposing revisions to improve the drafting conventions of the Code. The explanatory memorandum stressed that the IESBA was seeking comments only on the proposed changes to the Code that were the result of the drafting conventions project.

The exposure period was three months and ended on October 15, 2008.

To date, comments have been received from the following:

Member Bodies of IFAC	21
Firms	8
Regulators and Oversight Authorities	3
Others	15
Total Responses	47

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=0116>.

At the December 2008 meeting, the IESBA considered the comments received on questions 1-4 in the exposure draft and provided comment on the Task Force's proposal to address these comments. The Task Force met directly after the December meeting and held two Task Force meetings in January 2009 (Jan 14th-16th and Jan 26th-27th) and held one conference call (Jan 29th) to consider the Board's input and other comments received on exposure.

The detailed cut and paste of comments is contained in Agenda Paper 2-C. Task Force members have each considered the comments and the Task Force has collectively discussed the more significant of those comments. The Task Force intends to collectively discuss all remaining comments during its February 26 and 27 meeting.

This paper discusses the significant issues considered by the Task Force and its recommendations to the Board. The Task Force's proposed changes to the exposure draft are presented in Agenda Papers 2-A and 2-B (mark-up and clean respectively).

Discussion

Exception Clause

The exposure draft contained an exception clause that provided that in exceptional circumstances a professional accountant may judge it necessary to depart from a specific requirement in the Code. The clause further stated that such a departure would be acceptable only if certain specified conditions were met.

The majority of respondents supported the inclusion of a provision that permits an exception, noting that there could be circumstances where compliance with a requirement would not serve the public interest and it was not possible to anticipate all circumstances that could be faced by professional accountants. A significant minority disagreed with the inclusion of the exception clause, expressing the view that it would weaken the Code and undermine its requirements. Some respondents also expressed the view that an exception might be abused.

At the December 2008 meeting, the IESBA discussed the exception clause, the exposure draft comments, and input from CAG members. As suggested by the CAG, the IESBA considered three categories of exceptions:

- Catastrophic events – such as a natural disaster or a terrorist act;
- Acquisitions and mergers; and
- Other situations.

Catastrophic events – The IESBA noted that the Code was not written for such circumstances and considered actions that had been taken in the past when there had been a catastrophic event – for example, when books and records of numerous companies had been destroyed as a result of a terrorist act, audit firms were allowed to assist their audit clients in recreating the destroyed data. In doing so, the audit firms provided services that are normally prohibited, but they were permitted to do so because the services were necessary to enable the clients to prepare their financial statements under an extraordinary circumstance and it was in the public interest for the audit firms to assist in that effort. The IESBA believes that if similar catastrophic events were to occur in the future, regulators and member bodies would again take appropriate action to enable firms to provide needed services that are in the public interest, and the Board believes that

result would be reasonable under such circumstance. Thus, there was no support by IESBA members to include in the Code an exception to address catastrophic events.

Acquisitions and mergers – The IESBA recognized that a client acquisition or merger can create independence issues for the firm because such transactions are outside the control of the firm and thrust upon the firm the unexpected need to be independent of one or more related entities of the audit client, sometimes in very short order. Accordingly, the IESBA was supportive of the Task Force addressing this issue and requested that the Task Force consider the matter and develop a recommendation for the IESBA.

Other situations – With respect to the need for an exception clause for other situations (other than catastrophic events and acquisitions and mergers), the IESBA was of the view that the examples considered to date in support of such a clause were not compelling and that without compelling examples, a general exception clause would weaken the Code. The IESBA was also concerned that such an exception could be subject to wide interpretation and potential abuse. For these reasons, there was insufficient support to include an exception clause in the Code, absent examples that clearly demonstrate a need for such a clause. The Board did not form view as to how accountants would proceed if faced with any such situations.

Acquisition & Mergers

The Code requires the firm and network firms to be independent of the audit client. In the case of an audit client that is a listed entity, independence from all of the audit client's related entities is required. In the case of an audit client that is not a listed entity, independence is required from related entities over which the client has direct or indirect control (see paragraph 290.27). A related entity is defined as an entity that has any of the following relationships with the client:

- (a) An entity that has direct or indirect control over the client if the client is material to such entity;
- (b) An entity with a direct financial interest in the client if such entity has significant influence over the client and the interest in the client is material to such entity;
- (c) An entity over which the client has direct or indirect control;
- (d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (c); and
- (e) An entity which is under common control with the client (a “sister entity”) if the sister entity and the client are both material to the entity that controls both the client and the sister entity.

Given that the definition of related entity incorporates, among other things, both “upstream” entities (an entity that has control over the audit client) and “downstream” entities (a subsidiary of the audit client), independence issues can be created when an audit client acquires another entity or is itself acquired, as well as when an entity becomes a sister entity of the audit client and materiality conditions are met.

In considering the implications of an audit client's merger or acquisition on an auditor's independence, the Task Force consulted specialists who deal with this area to obtain a better understanding of the types of interests and relationships that often need to be addressed, the amount of time typically available to address them, the process a firm would go through to identify and become independent of related entities and the time it can take to do so, and the types of safeguards that can be put in place.

Interests and relationships

The types of interests and relationships that can require attention in a client acquisition or merger situation can include any of the interests and relationships covered by the Code. The more typical interests and relationships include financial interests, loans, family and employment relationships, various non-assurance service relationships, and business relationships between the firm and the related entity.

Many of the interests and relationships can be safeguarded or terminated without much difficulty. For example, financial interests in the related entity are generally disposable if a ready market exists for the entity's shares. However, terminating some interests or relationships may have broader implications for the entity and those who benefit from the interest or relationship. For example, if a firm is providing a payroll service to the related entity that includes the calculation and remittance of payroll taxes to the government, terminating that service before the entity has engaged a new payroll service provider could adversely affect the timing of the entity's remittances of payroll taxes and, thus, the timing of receipt of tax revenues by the government. Similarly, if a firm is providing software support to customers of the related entity, terminating that relationship before the entity has engaged a new support provider could adversely affect thousands of third-party users of the software.

Certain fee arrangements may also exist with the new related entity that would not be permissible for an entity requiring independence and, thus, would need to be restructured, often requiring renegotiations with the related entity.

Time typically available to address independence issues

One of the most important factors affecting a firm's ability to become independent of a new related entity is the amount of time it has to implement safeguards or terminate the interests or relationships it has with the entity. In a business environment that is more typical than what has been experienced in the last several months, firms often have advance notice of a client's proposed acquisition or merger. That is often the case with a large acquisition involving a listed entity. In those cases, the Task Force understands that most interests and relationships generally can be terminated by the effective date of the merger or acquisition. In some cases, however, a firm may have little advance notice. While this has been the case for acquisitions by financial services companies in the last several months, it occasionally occurs in a more typical business environment. And, sometimes firms are informed of an acquisition after the fact. This might be the case with a non-listed entity where the firm's audit effort occurs mainly after the year-end and, as a consequence, the firm does not have on-going contact with the client throughout the year.

This is key issue. If a firm doesn't have sufficient notice of a transaction, it may not have enough time to apply safeguards or work out a termination arrangement for various interests and relationships. For example, for some interests or relationships, the firm and the related entity may need additional time so that illiquid investments in the related entity (mainly private companies) can be disposed of, material firm loans can be moved or safeguarded, and family relationship issues can be resolved. Certain non-assurance services and business relationships, particularly those where the firm is deeply entrenched in a part of the related entity's business (e.g., software support to the related entity's customers), also need to be moved to another service provider in a way that minimizes the potential extent of harm to third parties. If there is insufficient notice of a transaction, the firm is not likely to become independent of the related entity as of the effective date of the merger or acquisition. What constitutes sufficient advance notice depends on the types of interests and relationships that require safeguarding or termination.

Process of identifying and becoming independent of new related entities

When the firm determines that the audit client is involved with an acquisition or merger, the firm needs to:

- Identify the entities that will become related entities of the audit client;
- Identify the firm's and network firms' interests or relationships with the new related entities that create independence issues; and
- Terminate the interests or relationships that are not permitted under the Code and, when the interest or relationship is permitted with safeguards, apply safeguards to eliminate the threats or reduce them to an acceptable level.

The process of identifying related entities can be time consuming for both the firm and the client, particularly when the acquisition or merger involves a large multi-national company with numerous related entities. For example, the Task Force understands that in some cases it can take several weeks to obtain the information from various parts of the world that is necessary to perform an analysis of which entities are related entities. As the analysis progresses, discussions with the client about certain entities often occur and additional information is sometimes needed, which further extends the time it takes to perform the analysis. Although not common, we understand the analysis process for larger companies with multiple related entities can sometimes take up to 6 months to complete.

The process of identifying any interests or relationships with related entities that create independence issues can also be time consuming because the firm needs to identify not just its own interests and relationships but also those that exist between network firms and the related entities. Independence issues could be created by non-assurance services provided to a related entity – for example, a firm or network firm might be providing a prohibited service to a related entity or might be providing a service that would only be permitted if specified safeguards are in place. Information about the non-assurance services that network firms provide to non-assurance clients and their related entities is typically not maintained at a network level, making this identification process

challenging and potentially lengthy to complete. Independence issues could also be created by other interests or relationships that the firm has with the related entity – for example, financial interests held by the firm or by members of the audit team.

Task Force Recommendation

The Task Force believes that guidance to assist firms in dealing with the independence implications of a client merger or acquisition would be a useful addition to the Code. The Task Force understands that most interests and relationships are capable of being safeguarded or terminated by the effective date of a merger or acquisition. In some cases, however, an interest or relationship cannot reasonably be terminated before the acquisition or merger is effective, as might be the case where the firm is providing a prohibited non-assurance service to the related entity and a period of time after the effective date of the merger or acquisition is needed for the entity to find another service provider that can perform the service, or where an individual is unable to dispose of a financial interest by the effective date of the merger or acquisition because, for example, the market is closed or the financial interest is illiquid. For those types of situations, the Task Force believes that a provision in the Code that guides the firm as it works its way to resolution of the issues would be appropriate.

Further, proceeding with the development of guidance in this area would be consistent with the views of twelve respondents to the ED who recommended that the IESBA include such guidance to deal with situations where additional time is needed to terminate an interest or relationship. Some of those respondents also expressed concern that without some form of transitional guidance, an interest or relationship that is terminated even one day after the effective date of a merger or acquisition would mean that the firm would literally be viewed as not independent under the new drafting conventions. The Task Force does not believe that such a result is in the public interest.

The Task Force recommends that any guidance on this subject first reinforce the need for the firm to bring itself into compliance with the requirements of the Code. In cases where the interest or relationship cannot reasonably be terminated by the effective date, the Task Force recommends that the Code provide a limited period of time after that date during which firms and clients can accomplish the termination. Among other things, during that period of time the engagement team for the audit should be "clean," meaning that none of the individuals on the team have any such interest or relationship, including performing non-assurance services that need to be terminated.

"Cannot reasonably be terminated"

It is important to note that by using the phrase "cannot reasonably be terminated," the Task Force contemplates that all reasonable efforts will be made by the firm and the client to terminate the interest or relationship. A termination that is delayed merely because it would be inconvenient for the client or the firm to terminate the interest or relationship would not be an interest or relationship that "cannot reasonably be terminated." Factors that the Task Force considered in determining whether an interest or relationship cannot reasonably be terminated include:

- A disruption in the service might be harmful to those who rely on the service and therefore not in the public interest (for example, in the case of payroll and related tax services or software support services);
- The timing of the merger or acquisition is such that the related entity needs time after the effective date to identify alternative service providers and contract with a new provider and time for the firm to transition the service to the new provider.

The Task Force proposes that the guidance stipulate that the interest or relationship be terminated as soon as possible, but that in no event shall the interest or relationship continue beyond a period of six months after the effective date. The Task Force considers six months to be a reasonable period of time that should allow most interests and relationships to be terminated. When combining this limited period of time with the application of appropriate transitional measures during that period, the Task Force believes a balance is achieved between (a) the need for the firm to comply with the independence requirements of the Code as soon as possible and the importance of doing so to protect the public interest, and (b) the benefits of avoiding needless market disruption, which can be caused by a forced and unplanned change of auditors at the effective date of the acquisition.

In some cases where the audit client is acquired by another entity, the firm will complete the current period's audit and be replaced as auditor. The Task Force is of the view that in such situations, provided certain conditions have been met, it is not necessary for the firm to terminate the interest or relationship with the new upstream related entity. The conditions that would need to be met are (a) the firm will remain as auditor only for a short period of time after the effective date and will be replaced as auditor after issuing the next audit report, (b) no individuals with such an interest or relationship are members of the engagement team or key audit partners and (c) if the interest or relationship relates to a non-assurance service, no members of the engagement team or key audit partner performs that non-assurance service. In addition, the firm would determine what transitional measures were necessary. The Task Force is of the view that such an approach is an appropriate solution to the situation in which the firm is going to resign as auditor shortly after the effective date of the merger or acquisition.

The Task Force proposes that the guidance provide examples of factors that would be considered in determining what transitional measures, if any, are necessary. The factors that would be considered include:

- The nature and significance of the interest or relationship – if the interest or relationship is significant, the transitional measures may need to be more extensive;
- The nature and significance of the related entity relationship – providing a restricted service to a downstream related entity may require more extensive transitional measures than providing the same service to an upstream related entity. Further, if a downstream audit client is a significant component of the upstream non-client parent, the auditor of the parent will review the audit under ISA 600, which can provide an added measure of comfort;

- The length of time before the interest or relationship is terminated – if the interest is terminated one day after the effective date the transitional measures may not need to be as extensive as if the interest continues for five months after the effective date;
- Whether the firm will continue as auditor – for example if the firm will be replaced as auditor the transitional measures may not need to be as extensive.

In addition, the Task Force recommends that if a firm avails itself of the additional time period set out in the M&A clause, the matter should be discussed with those charged with governance and documented. The Task Force will consider the extent to which there may be confidentiality considerations before a firm can discuss an interest it has with a related entity with those charged with governance.

The Task Force considered recommending that discussion with a regulator be required. The Task Force noted that in some instances the accommodation may be for a very short period of time or might relate to a relatively minor matter. Further, if the firm and the client are working toward resolution of an interest or relationship as soon as possible with the understanding that the interest or relationship cannot extend beyond six months after the effective, there is a clean engagement team, and transitional measures are applied as necessary under the circumstances, it would not be necessary to require firms to discuss the matter with regulators. The Task Force, therefore, concluded that such discussion should not be mandated.

In consideration of the above, the Task Force proposes the following wording to address independence issues created by client acquisitions or mergers:

Mergers or Acquisitions

290.28 If, as a result of a merger or acquisition, an entity that is not an audit client becomes a related entity of an audit client, the firm shall identify and evaluate threats to independence created by any interests or relationships the firm, a partner or employee has with that related entity, as required by this section. If the threats identified are not at an acceptable level, the firm shall apply safeguards to eliminate the threats or reduce them to an acceptable level or terminate the interest or relationship by the effective date of the merger or acquisition.

290.29 There may be circumstances when safeguards cannot be applied and the interest or relationship cannot reasonably be terminated by the effective date of the merger or acquisition, for example, because the related entity is unable to effect an orderly transition to a qualified service provider of a non-assurance service provided by the firm, by the effective date. In such circumstances (a) the interest or relationship shall be terminated as soon as possible and in all cases within six months of the effective date of the merger or acquisition; (b) any individual who has such an interest or relationship shall not be a member of the audit engagement team or a key audit partner for the audit client; (c) when the threat is created by a non-assurance service, any individual performing that non-assurance service shall not be a member of the audit engagement team or a key audit partner for the audit client; and (d) transitional measures shall be applied, as necessary.

290.30 As a result of a merger or acquisition an entity that is not an audit client may become a related entity of an audit client by acquiring control of the audit client. In that situation, if the firm, a partner or employee has an interest or relationship with the related entity, that creates a threat that is not at an acceptable level, the interest or relationship is not required to be terminated if safeguards are applied in accordance with paragraph 290.28 or if the following conditions are met (a) the firm will be the auditor only for a short period of time after the effective date of the merger or acquisition and will be replaced after issuing its next audit report, (b) any individual who has such an interest or relationship is not a member of the audit engagement team or a key audit partner for the audit client; (c) when the threat is created by a non-assurance service, any individual performing that non-assurance service is not a member of the audit engagement team or a key audit partner for the audit client; and (d) transitional measures are applied, as necessary.

Transitional Measures

290.31 In determining what transitional measures are appropriate, the firm shall consider factors such as:

- The nature and significance of the interest or relationship;
- The nature and significance of the related entity relationship (for example, whether the related entity is a subsidiary or parent);
- The length of time until the interest or relationship can be terminated; and
- Whether the firm will continue as the auditor of the client after the next audit report has been issued.

Examples of transitional measures include:

- Having a professional accountant review the audit or non-assurance work as appropriate;
- Having a professional accountant, who is not a member of the firm expressing the opinion on the financial statements of the client, perform a review that is equivalent to an engagement quality control review; and
- Engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.

Discussion with Those Charged with Governance

290.32 The firm shall discuss with those charged with governance the interest or relationship that will not be terminated by the effective date of the merger or acquisition including, in cases where the interest or relationship cannot reasonably be terminated by the effective date, the reasons why, and discuss the transitional measures, if any, to be applied. This communication enables those charged with governance to (a) consider the firm's judgments in identifying and evaluating threats to independence created by the merger or acquisition, (b) consider the appropriateness of the transitional measures to be applied, and (c) take appropriate actions.

Documentation

290.33 The firm shall document the interests or relationships identified under paragraph 290.28 that will not be terminated by the effective date of the merger or acquisition including, in cases where the interest or relationship cannot reasonably be terminated by the effective date, the reasons why, the transitional measures applied, and the results of the discussion with those charged with governance.

Lack of information

In some instances, there could be a delay in obtaining information that goes beyond the 6-month period recommended above. In those cases, the firm is unable to conclude that it has identified the entities and relevant interests and relationships and is unable to take appropriate action. Application of the proposed M&A clause in that situation would result in the firm not being in compliance with the requirements of the Code. Accordingly, the Task Force believes that the firm would be unable to represent that it is independent.

Quality of information

Firm's typically cannot have 100% assurance that the information they have about a client's related entities and the firm and network firms' interests and relationships with those related entities is always complete and accurate, despite their and the client's best efforts. Firms should make all reasonable attempts to obtain the necessary information, implement an appropriate course of action, and determine whether they are in compliance with the independence requirements of the Code. In those cases, if new information about interests or relationships surface subsequent to the 6-month period, and those interests or relationships are not permitted under the Code or permitted only with the application of safeguards (and no safeguards have been applied), that situation should be treated as an inadvertent violation. The Task Force believes such treatment should be consistent with the treatment of any other prohibited interest or relationship that comes to the firm's attention.

IESBA Question

IESBA members are asked to consider whether they agree with the Task Force's proposal to address independence issues created by client mergers or acquisitions.

Inadvertent violations

Paragraph 290.39 states that if an inadvertent violation occurs, it generally will not be deemed to compromise independence provided the firm has appropriate quality control policies and procedures in place to maintain independence and, once discovered, the violation is corrected promptly and any necessary safeguards are applied to eliminate any threat or reduce it to an acceptable level. While this paragraph and other inadvertent violation provisions were not changed as part of the drafting conventions project, one

respondent (IOSCO) did comment on this area. The respondent stated that “writing an exception for inadvertent violations which implies that all such violations can be corrected through application of 'any necessary safeguards' may encourage unscrupulous behavior and potential abuse of compliance with the Code and should be removed.”

The Task Force is of the view that the inadvertent violation provisions of the Code do not encourage unscrupulous behavior and potential abuse. However, the Task Force recommends that paragraph 290.39 be strengthened by making explicit reference to International Standards on Quality Control (ISQC). Paragraph 290.12 states that a firm is required by ISQC to establish policies and procedures designed to provide it with reasonable assurance that independence is maintained when required by ethical requirements. ISQC also provides requirements with respect to breaches of independence requirements (see Appendix B for extract). The Task Force is of the view that it would be useful to provide a reference to ISQC in paragraph 290.39.

The Task Force also noted that a question had been raised about the meaning of “inadvertent.” While the Task Force is of the view that the meaning of inadvertent should be consistent with its general usage (i.e., “unintentional,” “in error,” or “by mistake”), the Task Force believes that the clarity of the provision might benefit be enhanced by some discussion of the role of management. For example, the Task Force is of the view that a violation of the Code should not be characterized as “inadvertent” if management of the firm was aware of a planned action that would violate the Code and either condoned the act or did not take steps to prevent it.

IESBA Question

IESBA members are asked to consider this issue and whether they agree with the Task Force’s view on the role of management and, if so, whether this should be addressed in the Code.

Documentation

At the December 2008 meeting, the IESBA discussed the documentation requirements. The Task Force proposed some changes in response to exposure draft respondents to strengthen the requirements and, in particular, to require documentation of threats that were “at the margin.” The IESBA agreed with the direction of the Task Force but felt that the proposed language did not achieve its objective, was too broad and could be interpreted as requiring documentation of all threats – not only threats that are at the margin and threats for which safeguards were applied. The Task Force has considered the Board’s direction and proposes the following (the text is shown in mark-up from the text discussed by the Board in December 2008):

290.35 Documentation provides evidence of the professional accountant's judgments in forming conclusions regarding compliance with independence requirements; it is not a determinant of whether a firm is independent.

The professional accountant shall document conclusions regarding compliance with independence requirements, and the substance of any relevant discussions that support those conclusions. Accordingly:

- When a threat requires safeguards to reduce the threat to an acceptable level, the documentation shall include the nature of the threat and the safeguards in place or applied that reduce the threat to an acceptable level; and
- When a threats are identified is such that require the professional accountant to determine considered whether safeguards were necessary and concluded that they were not because are in place or need to be applied to reduce the threats to was already at an acceptable level, the professional accountant shall also the documentation shall include that conclusion and describe the nature of those the threats and the safeguards, if any, in place or applied that reduce the threat to an acceptable level.

IESBA Question

IESBA members are asked to consider whether they agree with the Task Force's proposed change.

Effective Date

The exposure draft proposed that the revised Code be effective on December 15, 2010, subject to transitional provisions, with earlier adoption encouraged. The effective date was based on the projected release of the Code in June 2009.

The exposure draft proposed that the revised Code become effective at a point in time rather than starting with fiscal years that begin after a specified date. It was felt that this would make the effective date provisions of the Code simpler to apply and easier to understand. It would also ensure that all situations were dealt with evenhandedly and that compliance with the revised Code would not be delayed simply because an entity has a different fiscal year-end. Thus, if the revised Code became effective on December 15, 2010, the independence provisions in the existing Code would, for example, be effective through December 14, 2010 and the new independence provisions set out in the exposure draft would be effective on and after December 15, 2010.

The following three transitional provisions were proposed:

- *Partner Rotation*—The revised Code will extend the existing partner rotation requirements to all key audit partners and to all firms, irrespective of size (absent a regulator's exemption). Where the proposals would require additional individuals to rotate (i.e., those not required to rotate under the provisions of the existing Code) an additional year would be provided before this requirement is effective for those individuals. For example, key audit partners who are neither the engagement partner nor the individual responsible for the engagement quality control review would be subject to the rotation requirements on December 15, 2011. Any individuals who had served in such a position for seven or more years on December 15, 2011 would be required to rotate off the engagement team and would not be permitted to be a member of the engagement team or a key audit partner for two years.
- *Entities of Public Interest*—The revised Code will extend the independence requirements that apply with respect to the audits of listed entities to all other public interest entities, as defined. The transitional provisions would provide an additional year after the effective date before these requirements are effective. These requirements would be effective on December 15, 2011.
- *Provision of Non-Assurance Services*—The revised Code will expand some of the restrictions on providing certain non-assurance services to audit and review clients. A firm should not contract for such services after the effective date of the revised Code and any ongoing services that were contracted for before the effective date should be completed within six months after that date. Therefore, a firm should not contract for any such services after December 14, 2010 and any ongoing services that were contracted for before this date should be completed by June 15, 2011.

39 respondents commented on this matter with a significant majority in support of the proposals.

	Member Bodies	Firms	Others
Support	AICPA, CICPA, CIMA, ICAEW, MIA, FARS, ICPAS, ACCA, AIA, HKICPA, ICAS, ICAA, ICPAC,	GTI, RSM,KPMG	APB, CARB, CCAB, FEE, VSCPA, IRBA
Agree with point in time but 18 months is ambitious			Mazars
No comment	IDW		
Agree but point in time should be January 1, 2011		DTT	
Effective date should apply to fiscal period	CNCC, CSOEC, CICA, NIVRA		Shum
Agree but transitional		BDO	

provision for partner rotation is not necessary			
Agree but would have marginal preference for an earlier effective date to provide for earlier implementation of IT1 and IT2			Basel
Agree but additional transition to June 2011 not necessary for non-assurance services		EY	
Agree but in exceptional circumstances provide additional time to complete existing non-assurance services (December 2011)		PwC	
Agree but should be a “fresh-start” for provisions when PIE fees exceed 15%	JICPA		
Concern with transitional periods and seeming differing effective dates and it is unclear how a firm would implement different portions of the Code at interim points in the client’s year.	SAICA		IOSCO

(Appendix A contains an index to respondents)

The Task Force has considered the comments received and recommends that the revised Code be effective at a point in time approximately 18 months after it is issued. One respondent (DTT) noted that because the proposed point in time effective date is so close to the calendar year end, it would be clearer, and easier, for all parties to implement if the effective date were January 1, 2011. The Task Force is of the view that this would be a simpler approach and, therefore, recommends the effective date be January 1, 2011 with non-assurance services to be completed by July 1, 2011.

The Task Force discussed how the partner rotation provisions would apply with a point in time effective date. The explanatory memorandum to the exposure draft stated that an additional year would be provided for individuals who were now required to rotate. The Task Force is of the view that a point in time effective date for partner rotation could require an individual to rotate in the middle of an engagement or just prior to the end of an engagement for a calendar year-end audit client. The Task Force, therefore, recommends the transitional provision for partner rotation be linked to the audit client’s fiscal period. To provide for the additional year proposed in the exposure draft,

individuals now subject to the rotation requirements would be required to rotate for fiscal periods beginning on or after December 15, 2011 if they had served as a key audit partner for seven or more years. (The selection of December 15th provides for year-ends just before December 31st, such as in the case of retail companies that have a 53 week year).

The Task Force considered the comments regarding the proposed transitional provisions. It agrees with the respondent (JICPA) who stated that the provisions should be explicit that a “fresh-start” approach is to be adopted for the requirements related to relative size of fees. The Task Force is of the view that this transitional provision also be linked to the audit client’s fiscal period and should, therefore, be effective for fiscal periods beginning on or after December 15, 2010. Under this approach, assuming the client had a December 31 year end, a pre- or post-issuance review would only be required if the total fees from a public interest entity audit client exceed 15% of the firms total fees for the years 2011 and 2012 and accordingly, the review would be conducted with respect to the 2012 audit. Without such a fresh-start the change would be applied retrospectively.

The Task Force is of the view that no other changes to the transitional provisions are necessary.

The Task Force considered the responses to the proposal that early adoption of the Code be encouraged. Some respondents, while agreeing with the effective date, stated it was ambitious. The Task Force notes that some firms and member bodies may need the full 18 months to effect an orderly implementation of the changes. The Task Force, therefore, recommends that the revised Code contains a more neutral statement that early adoption of the requirements is permitted, thus avoiding the any implication that a hurried approach is desired.

IESBA Question

IESBA members are asked to consider whether they agree with the Task Force’s proposed changes regarding the effective date.

Principles/Rules and Use of “Shall”

At the December 2008 meeting, the IESBA discussed respondents’ comments regarding the proposed use of “shall” in the Code. The Board agreed that the Task Force should review the usage of the word “shall” with the view to determining that each usage is appropriate. The Task Force has conducted this review mindful of the statement in 100.4 that “the use of the word ‘shall’ in this Code imposes a requirement...” The Task Force notes that, in some cases, the exposure draft expressed a principle with the use of the word “shall” (for example paragraph 100.5 describes fundamental principles using the word shall). The Task Force believes that the clarity of the Code would be improved if “shall” was used solely to convey requirements and has proposed changes to achieve this (for example, 100.18, 140.2, 140.8 & 210.6).

IESBA Question

IESBA members are asked to review the proposed changes to the usage of “shall” in Agenda Paper 2-A and consider whether they agree with the Task Force’s proposal.

Material Presented

Agenda Paper 2	This Agenda Paper
Agenda Paper 2-A	Proposed changes to exposure draft (mark-up)
Agenda Paper 2-B	Proposed changes to exposure draft (clean)
Agenda Paper 2-C	Detailed cut and paste of comments

Please note that Agenda Paper 2-A containing the mark-up will be used in the meeting for the detailed read of the Code.

Actions Requested

1. IESBA members are asked to consider the questions contained in the agenda paper.
2. IESBA members are asked to consider the conclusions presented in this paper and determine whether they agree with the rationale provided.
3. IESBA members are asked to read the proposed changes to exposure draft and provide input to the Task Force.

Appendix A
ED Respondents Legend

AAT	Association of Accounting Technicians
ACCA	Association of Chartered Certified Accountants
AIA	Association of International Accountants
AICPA	American Institute of Certified Public Accountants
APB	Auditing Practices Board (UK)
APESB	Accounting Professional and Ethical Standards Board – Australia
Basel	Basel Committee on Banking Supervision
BDO	BDO Global Coordination B. V.
CARB	Chartered Accountants Regulatory Board – Ireland
CCAB	The Consultative Committee of Accountancy Bodies
CEBS	Committee of European Banking Supervisors
CICA	Canadian Institute of Chartered Accountants
CICPA	Chinese Institute of Certified Public Accountants
CIMA	Chartered Institute of Management Accountants
CNCC	Compagnie Nationale des Commissaires aux Comptes
CSOEC	Conseil Supérieur de l'Ordre des Experts-Comptables
DTT	Deloitte Touche Tohmatsu
EYG	Ernst & Young Global Limited
FARS	The Institute for the Accountancy Profession in Sweden
FEE	Federation des Experts Comptables Europeens
GTI	Grant Thornton International
HKICPA	Hong Kong Institute of Chartered Accountants
ICAA/CPA Aus/ NIA	The Institute of Chartered Accountants in Australia/ CPA Australia/ National Institute of Accountants in Australia
ICAEW	The Institute of Chartered Accountants in England and Wales
ICAS	Institute of Chartered Accountants of Scotland
ICPAC	The Institute of Certified Public Accountants of Cyprus
ICPAS	Institute of Public Accountants in Singapore
IOSCO	International Organisation of Securities Commissions
IDW	Institut der Wirtschaftsprüfer (Germany)
IIA	Institute of Internal Auditors
IRBA	Independent Regulatory Board for Auditors
JICPA	Japanese Institute of Certified Public Accountants
JM	Joseph Maresca
KICPA	Korean Institute of Certified Public Accountants
KPMG	KPMG
LSCA	London Society of Chartered Accountants
NASBA	National Association of State Boards of Accountancy
Mazars	Mazars
MIA	Malaysian Institute of Accountants
MS	Mark Shum
NIVRA	Koninklijk Nederlands Instituut van Registeraccountants (Royal NIVRA)
PwC	PricewaterhouseCoopers

RM	Ramachandran Mahadevan
RSM	RSM International
SAICA	South African Institute of Chartered Accountants
VSCPA	Virginia Society of Certified Public Accountants
Wpk	Wirtschaftsprueferkammer

Appendix B

Independence Requirements and Application Guidance Contained in ISCQ1

Requirements

Relevant Ethical Requirements

24. The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements. (Ref: Para. A4-A6)

Independence

25. The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including network firm personnel), maintain independence where required by relevant ethical requirements. Such policies and procedures shall enable the firm to:
- (a) Communicate its independence requirements to its personnel and, where applicable, others subject to them; and
 - (b) Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.
26. Such policies and procedures shall require:
- (a) Engagement partners to provide the firm with relevant information about client engagements, including the scope of services, to enable the firm to evaluate the overall impact, if any, on independence requirements;
 - (b) Personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken; and
 - (c) The accumulation and communication of relevant information to appropriate personnel so that:
 - (i) The firm and its personnel can readily determine whether they satisfy independence requirements;
 - (ii) The firm can maintain and update its records relating to independence; and
 - (iii) The firm can take appropriate action regarding identified threats to independence.
27. The firm shall establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements, and to enable it to take appropriate actions to resolve such situations. The policies and procedures shall include requirements for:
- (a) Personnel to promptly notify the firm of independence breaches of which

- they become aware;
- (b) The firm to promptly communicate identified breaches of these policies and procedures to:
 - (i) The engagement partner who, with the firm, has the responsibility to address the breach; and
 - (ii) Other relevant personnel in the firm and, where appropriate, the network, and those subject to the independence requirements who need to take appropriate action; and
 - (c) Prompt communication to the firm, if necessary, by the engagement partner and the other individuals referred to in subparagraph (b)(ii) of the actions taken to resolve the matter, so that the firm can determine whether it should take further action.
28. At least annually, the firm shall obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by relevant ethical requirements. (Ref: Para. A7)
29. The firm shall establish policies and procedures:
- (a) Setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time; and
 - (b) For all audits of financial statements of listed entities, requiring the rotation of the engagement partner after a specified period in compliance with relevant ethical requirements. (Ref: Para. A8-A13)

Application and Other Explanatory Material

Relevant Ethical Requirements (Ref: Para. 24)

- A4. The IFAC Code establishes the fundamental principles of professional ethics, which include:
- (a) Integrity;
 - (b) Objectivity;
 - (c) Professional competence and due care;
 - (d) Confidentiality; and
 - (e) Professional behavior.
- A5. Part B of the IFAC Code includes a conceptual approach to independence for assurance engagements that takes into account threats to independence, accepted safeguards and the public interest.
- A6. The fundamental principles are reinforced in particular by:
- The leadership of the firm;

- Education and training;
- Monitoring; and
- A process for dealing with non-compliance.

Independence for assurance engagements is so significant that it is addressed separately in this ISQC, paragraphs 25 to 29.

Independence

Written Confirmation (Ref: Para. 28)

- A7. The purpose of obtaining confirmation in paper or electronic form and taking appropriate action on information indicating non-compliance is to demonstrate the importance that the firm attaches to independence and to make the issue current for, and visible to, its personnel.

Familiarity Threat (Ref: Para. 29)

- A8. The IFAC Code discusses the familiarity threat that may be created by using the same senior personnel on an assurance engagement over a long period of time and the safeguards that might be appropriate to address such a threat.
- A9. In determining appropriate criteria to address a familiarity threat, the firm may consider such matters as:
- The nature of the engagement, including the extent to which it involves a matter of public interest; and
 - The length of service of the senior personnel on the engagement.

Examples of safeguards include rotating the senior personnel or requiring an engagement quality control review.

- A10. The IFAC Code recognizes that the familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the IFAC Code requires the rotation of the engagement partner after a pre-defined period, normally no more than seven years, and provides related standards and guidance. National requirements may establish shorter rotation periods.

Considerations Specific to Public Sector Audit Organizations

- A11. The independence of public sector auditors may be protected by statutory measures, with the consequence that certain of the threats to independence of the nature envisaged by the material in paragraphs 25-29 and A8-A10 are unlikely to occur. However, threats such as self-review, familiarity and intimidation may still exist regardless of any statutory measures designed to protect independence. Public sector audit organizations consider how to appropriately address any such identified threats.
- A12. Listed entities as referred to in paragraphs 29 and A10 are not common in the public sector. However, there may be other public sector entities that are

significant due to size, complexity or public interest aspects, and which consequently have a wide range of stakeholders.

- A13. In the public sector, legislation may establish the appointments and terms of office of the auditor with engagement partner responsibility. As a result, it may not be possible to comply strictly with the engagement partner rotation requirements envisaged for listed entities. Nonetheless, for public sector entities considered comparable to listed entities, it may be in the public interest for public sector audit organizations to establish policies and procedures to promote compliance with the spirit of rotation of engagement partner responsibility.