

Minutes

International Ethics Standards Board for Accountants (IESBA)

CONSULTATIVE ADVISORY GROUP (CAG)

Held in Toronto, Canada on September 3, 2008

<i>Present</i> Richard Fleck (chair)	Financial Reporting Council
Gerald Edwards	Basel Committee on Banking Supervision
Marc Pickeur	Basel Committee on Banking Supervision
Kristian Koktvedgaard	Business Europe
Matthew Waldron	CFA Institute
Federico Diomeda	European Federation of Accountants and Auditors for SMEs
Jean-Luc Peyret	European Federation of Financial Executives' Institutes
Torben Haaning	Fédération des Experts Comptables Européens
Hilde Blomme	Fédération des Experts Comptables Européens
David Damant	IAASB Consultative Advisory Group and CFA Institute
Susan Koski-Grafer	International Organization of Securities Commissions
Patricia Sucher	International Organization of Securities Commissions
Lori Cox	Institute of Internal Auditors
David Morris	North American Financial Executives Institutes
Greg Scates	Public Company Accounting Oversight Board
Simon Bradbury	World Bank
Richard George	IESBA (chair)
Ken Dakdduk	IESBA Member
David Winetroub	IESBA Member
Jan Munro	IESBA Senior Technical Manager
Jim Sylph	IFAC Executive Director, Professional Standards
Aulana Peters	PIOB
<i>Regrets</i> Filip Cassel	International Organization of Supreme Audit Institutions
Vickson Ncube	Eastern Central and Southern African Federation of Accountants
Georges Couvois	European Federation of Financial Executives' Institutes
Tomokazu Sekiguchi	International Organization of Securities Commissions
John Hegarty	World Bank

A. Opening Remarks

Mr. Fleck welcomed all participants to the CAG meeting. He welcomed Lori Cox from the Institute of Internal Auditors, David Morris from the North American Financial Executives Institutes, Kristian Kotvedgaard from Business Europe, Jean-Luc Peyret from the European Federation of Financial Executives' Institutes and Matthew Waldron from CFA Europe. He also welcomed PIOB observer, Aulana Peters.

The minutes from the March 5, 2008 meeting were approved as presented.

B. Report from IESBA Chair

Mr. George reported that the IESBA had held two meetings and one conference call since the last CAG meeting in March 2008.

Mr. George reported that, at the April meeting, the IESBA had finalized the changes to the Code resulting from the Independence II exposure draft, subject to re-exposure of two issues.

- *Internal audit services* – The majority of respondents to the exposure draft agreed, explicitly or implicitly, with the proposal to permit the provision of internal audit services to audit clients provided that certain conditions are met. In considering the comments, the IESBA noted that the majority of regulators and independent standard setters responding to the exposure draft were of the view that there should be a restriction on providing financial internal audit services to audit clients that are public interest entities. The re-exposure draft proposes restricting such services;
- *Fees relative size* – The exposure draft proposed that when total fees from an audit client that is a public interest entity exceed 15% of the total fees of the firm, the self-interest threat created would be too significant unless the matter is disclosed to those charged with governance, and either a post or pre-issuance review is conducted not less than once every three years. The review would be conducted by a professional accountant from outside the firm. In considering the comments on exposure, the IESBA determined that the guidance should be strengthened in two respects. Firstly, to require either a pre-issuance or a post-issuance review of the second audit opinion and in each subsequent year when the fees continue to exceed 15%, and secondly, to indicate that when total fees significantly exceed 15%, the firm should determine whether the significance of the threat is such that a post-issuance review would not be sufficient and, therefore, a pre-issuance review is required.

The comment period for the re-exposure draft ends on August 31, 2008. The exposure draft comments and the proposed Task Force response will be discussed at the November 2008 CAG.

Mr. George reported that at its June 2008 meeting, the IESBA approved an exposure draft containing the proposed changes to the Code resulting from the drafting conventions project. This matter will be discussed under Agenda Item C.

C. Drafting Conventions

Mr. Dakdduk, Drafting Conventions Task Force Chair, introduced the topic. He reported that at its June meeting, the IESBA approved an exposure draft that reflects proposed drafting conventions changes throughout the Code. The exposure draft incorporates the output from Independence I and II. While the exposure period does not end until October 15, 2008, the matter was included on the CAG agenda to provide CAG members with the opportunity to discuss certain aspects of the exposure draft and provide some preliminary input to the Task Force. Mr. Dakdduk noted that it will be beneficial to the Task Force to have an understanding of the preliminary views of CAG members as it considers the detailed exposure draft comments. In addition, CAG members who will be involved in preparing responses to the exposure draft will have the opportunity to ask questions regarding the content of the exposure draft.

Temporary Departure from a Requirement

Mr Dakdduk indicated that “shall” replaces “should” in most parts of the Code and this is intended to more clearly convey a requirement. The implications of this are that it might not fit comfortably with a principles-based Code, might eliminate the use of professional judgment and could have unintended consequences for example:

- In a natural disaster situation;
- If a regulator was unwilling to waive compliance with the Code without an enabling provision; and
- It is not possible to anticipate all circumstances where such consequences could arise.

The IESBA concluded that there may be exceptional and unforeseen circumstances in which the application of a specific requirement in the Code may result in an outcome that a reasonable and informed third party would not regard as being in the interest of the users of the output of the accountant's professional services. Accordingly, the IESBA is proposing to include guidance in paragraph 100.11 of the Code under which, in exceptional and unforeseen circumstances that are outside the control of the professional accountant, the firm or employing organization, and the client, the professional accountant may judge it necessary to depart temporarily from a specific requirement. The provision states that such a departure would only be acceptable if all of the following conditions are met:

- The professional accountant discusses the matter with those charged with governance. The discussion includes the nature of the exceptional and unforeseen circumstance, the fact that the circumstance is outside the control of the relevant parties, why in the professional accountant’s judgment it is necessary to depart temporarily from a specific requirement in the Code, and any safeguards that will be applied;

- The professional accountant documents the matters discussed with those charged with governance;
- The nature of the departure and the reasons for the departure are appropriately disclosed to the users of the output of the professional services; and
- The professional accountant complies with the requirements of the Code at the earliest date that compliance can be achieved.

In addition, the exposure draft states that the professional accountant may wish to discuss the matter with the relevant regulatory authority. If the accountant has such a discussion, the exposure draft requires that the substance of the discussion to be documented.

Mr Dakdduk asked CAG members for their views on:

- Whether the Code should contain a provision permitting an exception?
- If yes, whether the necessary conditions were appropriate?
- If not, how such situations should be dealt with?
- Whether there were any other circumstances in which a departure would be acceptable?

Ms. Sucher responded that as the comment period was not until October 15th, she could only give some general reactions to the proposals. Firstly, without having a final position, she was concerned as to why such a paragraph was necessary. She noted that in unusual situations, such as a death or natural disaster, it might be necessary to take an unusual action. Her concern with providing an exception in the Code was that it might be used more widely than the IESBA intended.

Mr. Pickeur, Mr. Scates, Mr. Morris and Mr. Waldron concurred that there did not seem to be a need to include an exception paragraph in the Code.

Mr. Haaning noted that, without such a paragraph, there is a risk that a regulator or member bodies would take an opposite view that strict compliance with the Code was required.

Ms Koski-Grafer stated that she did not think that the examples cited supported the need for an exception, as she did not think that there was much risk that a regulator would, for example, bring a charge if an engagement partner remained on a client temporarily because of the sudden and unexpected death of the successor partner.

Mr. Morris noted that it was important to consider the issue from the perspective of the users of the financial statements and not solely from the auditor's perspective. Mr. Koktvedgaard agreed and noted that it was important that any departure from the Code be appropriately communicated.

Mr. Scates commented that the positioning of the exemption paragraph seemed to be problematic. He noted that it set the wrong tone and seemed to weaken the Code. He further noted that the profession does not need the Code to tell it how to deal with

exceptions. Professionals are accustomed to using professional judgment to deal with exceptional situations.

Ms Blomme stated that she would still like to see the Code as a principles-based Code and when you look at the requirements you can see that, in exceptional cases, there may be the need to depart. Without an exception paragraph, it would not be clear that a departure was acceptable.

Mr. Diomeda noted that while a departure from a principle would not be acceptable, a professional accountant should depart from a specific requirement if the departure was necessary to achieve compliance with the fundamental principles. In addition, he questioned whether it was necessary that the circumstances be outside the control of the relevant parties.

Mr. Pickeur indicated that his preliminary view was that he was not in favour of an exception paragraph because it seemed to be at odds with a principles-based Code and it also would weaken the move from “should” to “shall”. He noted that while in exceptional circumstances it might be appropriate to depart from a specific requirement, this does not need to be addressed in the Code because the relevant regulator would address the situation.

Mr. Edwards agreed, noting that the matter would be addressed by the relevant regulator in the particular jurisdiction. He also noted that, if the matter was to be addressed in the Code, it should be done in a positive way by requiring the professional accountant to discuss the matter with the relevant regulator.

Ms. Sucher expressed concern that the exception clause was placed at the beginning of the Code. She also noted that it may be problematic to have a clause that permits a departure from a specific requirement without knowing how that clause would be used.

Ms. Koski-Grafer agreed, noting that as the exception was written an engagement partner might use to the clause to argue a need to depart from the requirement to rotate because there were no other partners in the firm with sufficient industry expertise to assume the role of engagement partner on that particular client, when this should have been anticipated in the firm’s planning.

Mr. Morris questioned whether a discussion between the auditor and the regulator was sufficient or whether there should also be some communication with the users of the financial statements.

Mr. Pickeur stated that the example provided Code (the death of the successor partner) was perhaps a little contrived and a better example would be circumstances created by a natural disaster.

Mr. Diomeda noted that, taking driving as an example, an ambulance might go faster than a posted speed limit but the driver would still have to drive carefully and exercise due care.

Mr. Scates expressed concern with providing an exception at the beginning of the Code. He noted that it was problematic for the Code to state that the accountant shall comply with the Cod “except for...”. He noted that because exceptional circumstances are a fact of life, there are mechanisms to address and, as such, they do not need to be explicitly addressed in the Code.

Mr. Fleck stated that perhaps it would be more appropriate to address the matter at a higher level in a more principles approach. For example:

“Where an exceptional circumstance arises that could not reasonably be foreseen by the professional accountant that might mean that strict application with a specific provision of the Code would not be in the public interest, the professional accountant is expected to address that situation by exercising professional judgment in consultation with the firm or employing organization and any relevant regulator.”

Use of Shall

Mr. Dakdduk reported that application of the drafting conventions has replaced the word “should” with “shall” to convey a requirement. He noted that the IESBA was of the view that in certain circumstances the existing drafting of the Code clearly conveyed a requirement without the use of “shall” (for example, “a professional accountant is required”); in such circumstances the IESBA had not considered it necessary to revise the wording to include “shall”.

Ms. Sucher stated that if the intention was to clarify the Code, for consistency, all the requirements should be expressed using the word “shall”. She encouraged the IESBA not to be overly concerned with having more “shalls” in the Code. She expressed the view that there is no conflict if the rules flow from the application of the principles. She noted that the UK Code is also principles-based but it is very easy to see the absolute requirements because of the structure, and moving to “shall” in the IFAC Code will make the requirements clearer.

Mr. Pickeur stated that he was also of the view that it would be preferable to have consistency within the Code because using different terms to convey a requirement will lead people to question whether a different meaning was intended.

Mr. Morris and Ms. Koski-Grafer also expressed support for the consistent use of the word “shall”.

Other Drafting Matters

Ms. Koski-Grafer noted that under the existing Code, the professional accountant is required to identify all threats that were other than clearly insignificant, and apply

safeguards to eliminate the threats or reduce them to an acceptable level. There would presumably at times be threats that were above clearly insignificant, but below the level that is ultimately judged acceptable, which would have to be considered by the accountant. Under the proposed revisions, however, the accountant only is directed to address and document threats that are initially judged to be not at an acceptable level. She asked how the proposed change might alter the accountant's thought process of identifying, considering and making judgments on threats, particularly those that might be "at the margin" and, in the case of assurance engagements, the documentation requirements. Mr. Dakdduk responded that under the proposals all threats will need to be identified. It is likely that those threats that are de minimis will be dismissed but those that are at the margin will require judgement. He noted that International Standards on Auditing, and the proposed Code, require documentation of "conclusions regarding compliance with independence requirements, and any relevant discussions that support those conclusions."

Ms. Sucher stated that the explanation seemed clearer than as written in paragraph 290.21, noting that the phrase "the documentation shall also include" was confusing. In addition, the opening sentence ("Even though documentation is not, in itself a determinant of whether a firm is independent...") did not seem helpful and was unnecessarily defensive.

Ms. Sucher noted that the proposed restriction on internal audit services in paragraph 290.200 (providing internal audit services related to the internal accounting controls, financial systems or financial statements) might not be sufficiently comprehensive because it did not appear to address, for example, compliance with banking regulations, such as capital adequacy requirements.

Ms. Koski-Grafer stated that the term "non-recurring" could be interpreted in different ways. For example, if the internal audit activities performed related to one matter in the first year and to another matter in a second year, would both activities be considered to be non-recurring? Mr. Scates noted that the strong statement in paragraph 290.200 seemed to be undermined by the provision to permit non-recurring activities in paragraph 290.201.

Mr. Dakdduk indicated that the IESBA was mindful that some jurisdictions in the world, while prohibiting certain internal audit services, did allow some limited exceptions. He noted that the IESBA had tried to strike the right balance.

Mr. Pickeur noted that it would be useful to define what was meant by "internal audit services". He indicated that the definition provided by the Institute of Internal Auditing might be helpful in that regard:

"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance process."

Ms. Koski-Grafer noted that the description of activities in paragraph 290.195 was very broad and she was of the view that if those activities were performed by an internal auditor they would be internal audit activities, but if external auditor performed the activities they would not necessarily be internal audit activities but could instead be engagements for the external auditor to perform other agreed-upon procedures. She noted that the term “internal audit” for some carried the connotation that these were activities being regularly carried out to execute a company’s internal audit function, which would not be the same as asking a company’s external auditor to do additional external audit work or some other type of agreed-upon procedures.

Mr. Sylph noted that the International Auditing and Assurance Standards Board has received comment that there is no definition of internal audit services in the ISA addressing using the work of internal audit. He further indicated that the matter would be considered by the IAASB in March 2009.

Mr. George noted that the internal audit proposals were the subject of a separate re-exposure draft (together with some of the provisions related to fees) and would be discussed at the next CAG meeting.

D. Convergence

Mr. George, IESBA Chair, introduces the topic. He noted that the IESBA objective includes facilitating the convergence of international and national ethical standards. The IESBA Strategic and Operational Plan for 2008-2009 identified convergence of international and national ethical standards as a high priority. He indicated that globalization requires companies to comply with multiple sets of regulations and requirements and while substantial progress has been made in convergence of accounting and auditing standards, convergence of independence standards was less advanced. He indicated that the IESBA had prepared a draft convergence program which it intends to approve at its next meeting.

The draft convergence program recognizes that it is important that there is some common understanding of the use of the word “convergence”. The word can have different meanings in comparing national and global standards, including:

- Standards are fully converged and identical;
- Standards are “harmonized”; (e.g. both use the same approach but the language is different); and
- Standards achieve the same result – “equivalence” (somewhat less than harmonisation but have broadly similar effects)

Mr. George reported that the meaning proposed by IESBA was “Convergence is the process of moving towards the same point.”

Mr. George noted that there were difficulties with differing independence standards which included:

- Inconsistent understanding of independence among, investor, preparers and regulators;

- Greater risk of minor violations due to complexity of detail that do not impact independence in substance;
- Higher cost to preparers, auditors and regulators; and
- Somewhat reduced auditor choice.

He noted that the benefits that would result from convergence include:

- Investors and stakeholders will have a clearer understanding of independence;
- It will facilitate more efficient operation by preparers, auditors and regulators; and
- It will reduce duplication in compliance processes.

Mr. George stated that the IESBA recognized that there was a long way to go in achieving convergence and was developing a convergence program which contained the following actions:

- Development of toolkit and resources;
- Comparison of independence requirements in the Code with other jurisdictions;
- Liaison with interested parties;
- Holding a national standard setters meeting; and
- Promotion of the Code.

Mr. Fleck commented that convergence is a very important issue not only for IESBA but for all of IFAC.

Mr. Diomeda commented that convergence could be difficult not only for independence but also for the other parts of the Code. He noted that cultural differences might make it more difficult to achieve convergence of other sections of the Code.

Mr. Peyret commented that an important consideration in achieving convergence was enforcement of the requirements.

Ms. Blomme expressed support for the plan. She noted that the plan is clearly ambitious, even as it related to independence. She also stated that Fédération des Experts Comptables Européens would be pleased to assist in achieving the objective.

Mr Fleck commented that Mr. Hegarty has often expressed the view that the audit report should indicate the independence regime under which the audit was conducted. If convergence of independence standards was achieved this would not be necessary.

Mr. Edwards commented that the International Forum of Independent Audit Regulators is also interested in this matter and asked whether there had been any discussion with these individuals. Mr. George responded that two of the public members of IESBA were from audit regulators. He also noted that the European Commission and the PCAOB were observers on the IESBA.

Mr. Pickeur commented that with respect to the comparison of independence requirements in the Code with other jurisdictions, the legal architecture and environment

may explain why there are apparent differences. He questioned, rhetorically, whether IESBA would consider making changes to the Code as a result of the comparison.

Ms. Sucher made a personal observation that often the devil is in the details and it may be impossible to identify all the differences. She further noted that one way of facilitating greater convergence might be to adopt all of the IAASB clarity conventions.

Ms. Koski-Grafer noted that IOSCO had conducted a comprehensive survey of non-audit services and encouraged the IESBA to use the survey. She further noted that when conducting the IOSCO survey it became apparent that many of the respondents who indicated that they applied the IFAC Code seemed to interpret it differently because they answered certain specific questions about allowable practices in different ways. She also noted that, during the convergence process, it is likely that some jurisdictions may say that they are prepared to converge provided some changes are made to the Code. In this regard, she noted, the draft convergence plan does not acknowledge that the Code might need to change over time to achieve convergence. She also noted that such changes could conceivably add or subtract requirements depending upon the justification of specific proposals.

Mr. Morris questioned how much convergence had already been achieved and how many jurisdictions already have equivalent standards. Mr. Fleck noted that the UK is broadly similar but the standards have a different structure.

Mr. Scates commented that compliance was critical and without a mechanism to ensure compliance, convergence of standards would achieve very little.

Mr. George thanked the CAG members for their comments on the IESBA draft convergence program.

E. PIOB Comments

Ms. Peters, representing the PIOB, addressed the IESBA CAG. She noted that she had been pleased to observe the spirited discussion and the care with which the issues had been thought through. She observed that CAG members had provided very useful input that will be carefully considered by the IESBA. On the subject of convergence she observed that the group seemed to be sending the message that the IESBA has a long way to go on this road but it is the right direction. She closed her remarks by commenting that due process had worked well in the meeting.

Mr. Fleck acknowledged and thanked Ms. Peters for her remarks.

G. Presentation from CPAB

The IESBA received a presentation from Mr. Le Pan, Chair of the Canadian Public Accountability Board (“CPAB”) and Mr. Vallillee acting Chief Executive Officer of CPAB.

Mr. Le Pan stated that CPAB's mission is to contribute to public confidence in the integrity of financial reporting of public companies in Canada by promoting high quality, independence auditing. While the current focus is on public companies, he noted that an issue is whether CPAB should also consider other public interest entities. He noted that in Canada public companies that are audited by the Big Four accounting firms account for approximately 97% of the total market capitalization. There are, however, a large number of small public companies that are audited by small accounting firms, many of which audit only one or two public companies. With respect to the inspection of audit files, he noted that CPAB co-operates with the inspection programs of the accounting professions' provincial institutes. He noted that the reports on the results of the inspection are private between CPAB and the firm and that CPAB produces an annual public report. He further noted the decision had been taken that firms could not provide a copy of the private report to audit committees. CPAN felt that confidentiality was important for the effectiveness of the process.

Ms. Peters asked whether there was any legislation in Canada that was similar to the US Sarbanes-Oxley Act that put the audit committee of the company into the relationship. Mr. Le pan responded by saying that in Canada the relationship is between CPAB and the audit firm.

Mr. Vallillee highlighted some key messages from inspections that CPAB had conducted, noting that there were three areas in audit quality that had not improved as rapidly as CPAB would have liked:

- Overall quality of consultation and documentation – the standards require firm to document their audit work so that an experienced reviewer can ascertain what work has been done – which includes documentation of consultations that had taken place;
- Engagement quality control reviews – the standards require that all files are reviewed by a partner not connected with the file before the audit report is issued; and
- Quality monitoring – the process that permits the firm to assess the quality of work being performed by its partners and staff.

Mr. Vallillee noted that CPAB had compared its common findings with the common findings of other selected oversight agencies (the FRC, PCAOB and CPAAOB). He noted that there was a lot of common ground with findings related to:

- Documentation of professional judgment;
- Poor linkage of identified risks and audit procedures;
- Weak analytical review;
- Use of external experts;
- Use of internal specialists;
- Quality monitoring;
- Related party transactions;
- Review of service organizations;
- Inadequate quality control review; and
- Going concern assessment.

Commenting on the strategy and work plan of the International Auditing and Assurance Standards Board (“IAASB”), Mr. Vallillee stated that overall it was a robust plan and CPAB concurred with the view that there should be no relaxation of auditing standards for SMEs. With respect to implementation of ISAs, he noted that smaller firms would need more guidance. He noted that smaller audit firms have to address complex issues. Mr. Damant agreed with this point, noting that this is increasing the level of concentration in the industry.

Commenting on the IESBA’s Ethics Code, Mr. Vallillee stated that CPAB was comfortable with the proposed point in time effective date and was of the view that the proposed effective date would provide sufficient time for effective implementation. He noted that in Canada, independence requirements are a provincial matter. He also noted that in Canada public companies that have total market capitalization and total assets under \$10 million are treated as non public companies for independence purposes. Mr. Le Pan noted that this was a reasonable cost benefit accommodation for the Canadian environment. Mr. Koktvedgaard expressed the view that audits of public companies should be subject to the same independence requirements irrespective of size. Mr. Le Pan noted that he would not object if such a change was made in Canada.

Mr. Fleck thanked Mr. Le Pan and Mr. Vallillee for the presentation.

F. Closing

Mr. Fleck thanked all members of the CAG for their participation and closed the meeting.

G. Future Meeting Dates

November 24, 2008 (London, UK)