

## **Minutes**

### **International Ethics Standards Board for Accountants (ISEBA)**

#### **CONSULTATIVE ADVISORY GROUP (CAG)**

**Held in London, UK on November 24, 2008**

<i>Present</i> Richard Fleck (chair)	Financial Reporting Council
Marc Pickeur	Basel Committee on Banking Supervision
Kristian Koktvedgaard	Business Europe
Matthew Waldron	CFA Institute
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
Susan Leone	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
<i>Regrets</i> Gerald Edwards	Basel Committee on Banking Supervision
Federico Diomeda	European Federation of Accountants and Auditors for SMEs
Jean-Luc Peyret	European Federation of Financial Executives' Institutes
Vickson Ncube	Eastern Central and Southern African Federation of Accountants
Filip Cassel	International Organization of Supreme Audit Institutions
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 Susan Lione from the Institute of Internal Auditors and Greg Scates from the Public Company Accounting Oversight Board who was participating by conference call. He thanked CAG members for their flexibility in holding an additional meeting. He noted that the IESBA will be considering the comments on the drafting conventions exposure draft at their meetings in December and February with the view to approving a final document at its April meeting. The additional CAG meeting was, therefore, critical because it would provide CAG members the opportunity to provide early input on the proposed direction of the project. He noted that the March meeting would be an equally important CAG meeting as a CAG responsibility is to ensure that all exposure draft responses have been appropriately addressed.

## **B. Report from IESBA Chair**

Mr. George reported that the IESBA had not met since the last CAG meeting. The next IESBA meeting was on December 10-12, 2008 in London, UK. At that meeting, IESBA planned to approve the Independence II project and commence its discussion of the exposure draft comments received on the drafting conventions project.

## **C. Independence II**

Mr. Winetroub, Independence II Task Force Chair introduced the topic. He reported that in May 2008, the IESBA issued a re-exposure draft requesting comment on only three specific areas:

- The proposed restriction on providing internal audit services to public interest audit clients;
- Whether there should be an exception for immaterial internal audit services; and
- The required frequency of the application of the pre- or post-issuance review safeguard and the requirement to determine whether a pre-issuance review is required when total fees significantly exceed 15%.

The explanatory memorandum stressed that the IESBA was seeking views on only these matters was not seeking repetition of comments previously made. The exposure period was three months and ended on August 30, 2008 and 37 response letters were received. The Task Force has carefully considered all the responses received and developed proposals to address the comments.

### *Internal Audit Services*

Mr. Winetroub reported that the majority of respondents supported the proposal to prohibit firms from providing certain internal audit services to audit clients that are public interest entities. Several respondents that expressed support for the approach requested a clearer description of those services that were not permitted. He noted that a minority were not supportive. These respondents were of the view that the position in the first exposure draft was appropriate, namely that an audit firm should be permitted to provide internal audit services to an audit client that is a public interest entity provided certain conditions are met. The respondents felt that the case for the need for a prohibition had

not been made. One respondent stated the prohibition should depend on whether the auditor intends to rely on the internal audit services.

With respect to the proposal to permit firms to provide a non-recurring internal audit service, Mr. Winetroub reported that a minority of respondents expressed the view that there should not be an exception for such services. These respondents noted that there could be a substantial review threat if non-recurring material internal audit services were provided. In addition, there was no definition of a non-recurring internal audit service. It was also noted that this would be the only place where the Code permits an otherwise prohibited service solely because it is non-recurring in nature. In addition, one respondent stated that there should be no exemption for non-recurring services but rather there should be an exception for immaterial internal audit services. In addition, the respondent felt that the prohibition on “internal audit services that relate to the internal accounting controls, financial systems or financial statements” was not appropriate. The respondent expressed the view that because there was no definition of these types of internal audit services it could lead to inconsistent application of the standard. The respondent also stated that it may omit other internal audit services that could impact audit judgments – for example, it could be argued that, internal audit work on compliance with laws and regulations would be outside of the prohibition.

Mr. Winetroub reported that the exposure draft asked whether there should be an exception provided for immaterial internal audit services. The majority of respondents were supportive of such an exception. These respondents stated that an exception based on materiality is consistent with the conceptual framework approach and consistent with the approach taken with other non-audit services such as bookkeeping, IT systems services and valuation services. It was also noted that immaterial internal audit services would not create a self-review threat. A minority of respondents did not support such an exception noting that the term “immaterial” when related to internal audit services is unclear. One respondent did not support the use of exceptions to the Code’s general principles followed by explicit prohibitions because that the explicit prohibitions in the Code increases the likelihood that the principle underlying the reason for the prohibition will be undermined and compromised.

Mr. Winetroub reported that the Task Force had considered these comments and was proposing replacing paragraphs 290.200 and 290.201 with the following:

In the case of an audit client that is a public interest entity, a firm should not provide internal audit services that relate to:

- (a) Significant internal controls over financial reporting;
- (b) Financial systems that generate information that is significant to the client’s accounting records or to the financial statements on which the firm will express an opinion; or
- (c) Amounts or disclosures that are, separately or in the aggregate, material to the financial statements on which the firm will express an opinion.

The Task Force is of the view that the proposed change clarifies the prohibition and notes that parts (a) and (b) are aligned with the IT systems services prohibition. In addition,

because the prohibition is linked to significance or materiality there is no need for a separate exemption for immaterial internal audit services.

Ms. Koski-Grafer stated that she was pleased to see that the Task Force proposed to delete the provision to permit the provision of non-recurring internal audit services to an audit client.

Mr. Damant questioned whether the treatment of public interest entities should be consistent between the ISAs and the Code. Mr. Sylph responded that the way the IAASB views public interest entities is consistent with the Code. Mr. Fleck noted that the International Accounting Standards Board had taken a different approach. Ms. Koski-Grafer noted that it would be useful if someone prepared a paper that compared and if possible reconciled the different approaches. Mr Sylph indicated that IAASB had considered the matter and had concluded that the distinction would be made by using the term private entities.

Ms. Lione stated that she also agreed with the removal of the exception for non-recurring internal audit services but was concerned with the materiality provisions because of the amount of professional judgment that would be needed. She indicated that if there is to be a materiality clause it would be preferable to have an overall consideration of materiality as opposed to having a materiality clause in each of (a) through (c). Mr. Winetroub stated that the approach was consistent with other parts of the Code. He also noted that “materiality” is used when referring to matters than can be quantified, such as when referring to financial statement amounts, and “significance” is used when the matters cannot be quantified, such as when referring to internal control. He agreed that professional judgment would be needed but noted that the alternative was an absolute prohibition.

Mr. Pickeur stated that he was of the view that a bank would always be a public interest entity and the internal audit function of a bank should never be outsourced. He continued that in some entities it might be possible to outsource internal audit services. He liked the approach suggested by the Auditing Practices Board (“In the case of an audit client that is a public interest entity, a firm should not provide internal audit services where internal audit work is likely to be relied upon in making audit judgments related to matters that are, separately or in aggregate, material to the financial statements”).

Mr. Winetroub stated that the Task Force had carefully considered this language but were concerned that it could be misunderstood or abused. For example, it could be difficult to know whether the auditor had relied on the internal audit work or not. The Task Force, therefore, was of the view that it would be preferable to draw a brighter line and prohibit the services unless they were insignificant.

Mr. Morris asked whether any thought had been given to developing a more presumptive test whereby the auditor could only provide the internal services if it could be proved that they were insignificant. Mr. Winetroub responded that the proposed construction was consistent with other prohibitions in the Code that relate to materiality or insignificance.

He also noted that it would be difficult to “prove” insignificance it is a conclusion reached after applying professional judgment taking into account qualitative and quantitative matters.

Mr. Haaning noted that it was important to remember that the Code is used globally and will be translated into different languages. This calls for use of language that is as clear and as consistent as possible.

Ms. Koski-Grafer expressed concern with a materiality exception that relates to internal controls, noting that the issue was not only one of a self-review threat but also involved a potential conflict of interest and the external auditor’s requirement to decide whether reliance is going to be placed on the internal audit work. She stated a materiality exception could permit a rather large amount of internal audit work to be done, depending upon the kind of materiality test used, and that she would be more comfortable with a threshold of trivial and inconsequential or de minimis. She noted that the IOSCO comment letter; stated:

“Unless such services would be “de minimis” or “trivial and inconsequential” when any amounts involved are considered from the perspective of both the financial statements and the audit firm’s revenues, we do not think any internal audit services that relate to financial reporting should be provided. We are concerned that writing an exception like this into the Code creates the potential for inconsistent application and misuse.”

Mr. Damant said the term “de minimis” would not be understood or translated well in some countries.

She stated that she recognized that the proposed drafting was consistent with the drafting in other parts of the Code but felt that internal audit was different because it was often so closely related to matters affecting the financial statements. She suggested that, if the decision was taken to keep an immaterial exception, it would be useful to provide guidance on what would be considered an immaterial matter.

Mr. Winetroub responded, noting that while magnitude of fees for non-audit services is an issue for some, this matter is not addressed in the Code. Ms Koski-Grafer noted that the IOSCO letter was not commenting on fees for non-audit services in general, rather the comment was directed to the fees associated with non-audit services that related in some way to financial reporting.

Mr. Winetroub noted that there are other services that create a more significant self-review threat and have a materiality exception. He provided valuation services as an example, noting that immaterial valuation services were not prohibited by the Code. He noted that a client may request a firm to provide some internal audit assistance in a remote location. The Task Force was of the view that if these services were insignificant they should not be prohibited.

Ms. Blomme noted that FEE had not reached a consensus on the position proposed in the re-exposure draft. They had, however, looked at the approach that was proposed by the Task Force and were in agreement with what was now being proposed.

Mr. Koktvedgaard expressed the view that the definition of prohibited internal audit services could more aligned with the description of bookkeeping services. He also thought that there should be some mention of internal audit services related to compliance with laws and regulations. He noted that the ISAs require an auditor to report significant weaknesses in internal control and he would hope that the auditor could provide advice to the client on how to correct these deficiencies. He further noted that it might be difficult to see the difference between providing advice and performing internal audit work.

Mr. Winetroub responded that, with respect to compliance with laws and regulations, the auditor would need to assess whether there was a self-review threat. He also noted that the Code does not prohibit the auditor from providing advice to the client.

Mr. Pickeur questioned the use of the term “significant” noting that if a reason for the drafting was to be consistent with other sections of the Code, for example bookkeeping services, then those sections should be strengthened as well. Ms. Koski-Grafer echoed Mr. Pickeur’s concern and suggested deleting “significant” and “materiality” or alternatively incorporating the concept that the services must be separately and in the aggregate insignificant.

Mr. Fleck noted that there were two different approaches. The first approach, suggested by the Task Force, was based on significance and the second approach, as used by the APB, was based on reliance.

Ms. Koski-Grafer questioned whether reliance was best approach, as the closeness of and interrelationship of internal controls and the financial statements could raise threats regardless of reliance. She also stated that she recognized that the issue of materiality versus a lower or more narrowly defined threshold might be a case where the IESBA can only go so far with this particular round of Code changes due to current differing views in different countries, but in that case, this would be an area that the Board might wish to note as needing attention sometime in the future, especially as it seeks to further its work on convergence.

Ms. Lione noted that it was important the external auditor rely on the work of internal audit to minimize duplication of effort.

Mr. Scates stated that he agreed with the comments regarding greater clarity around the meaning of “significance”. He noted that this was not the only place where it appeared in the Code and agreed that this might be a matter that should be addressed in the future.

Mr. Fleck noted that the approach of not focussing on reliance does remove some of the judgment that the auditor has to make.

### *Fees*

Mr. Winetroub reported that the majority of the respondents were supportive of the proposed requirement of a pre- or post-issuance review each year after total fees from an audit client exceed 15% of the fees of the firm signing the audit opinion. A minority stated that a pre-issuance review should be required in certain situations; with others stating that a post-issuance review was sufficient. A minority of respondents did not support the proposal. These respondents noted:

- There will be difficulty in some jurisdictions in finding an accountant from outside of the firm to perform the review; and
- The safeguard should be applied not less than once every three years.

Mr. Winetroub reported that the Task Force had considered the comments received, noting that while the majority of respondents supported the frequency of application, some felt the safeguard should be strengthened (by requiring a pre-issuance review) and others felt a post-issuance review was appropriate. The Task Force concluded that the position in the re-exposure draft struck the appropriate balance.

Mr. Fleck asked whether the Task Force had considered adding a statement that if the fees significantly exceed 15% the firm should consider whether to withdraw from the engagement. Mr. Winetroub responded that it was implicit because the Code states that this action needs to be taken if threats cannot be reduced to an acceptable level.

Mr. Fleck stated that it might be useful in the future to provide some guidance on how a firm would address spikes in fees.

Ms. Koski-Grafer noted that there was a broad range of views on this matter at IOSCO and the approach proposed was probably the right balance for now. She noted, however, that the drafting could be improved to make it clear that the additional safeguard for the pre- or post-issuance review was applied to the second year's audit, as this had not been understood by all on first reading.

Mr. Morris stated that it would be useful to reverse the order in which the safeguards are mentioned. This would put the safeguards in their chronological order and would also emphasize the stronger safeguard, the pre-issuance review.

Ms. Blomme questioned whether the term “professional regulatory body” was meant to refer to a professional body or a regulator. Mr. Winetroub responded that, depending on the circumstances, it could mean both.

Mr. Pickeur questioned the meaning of the “firm expressing the opinion on the financial statements.” Mr. Winetroub responded that this construction was used to make it clear that the calculation was performed at the firm level and not at the network level.

Mr. Kjektvedgaard noted that the 15% threshold could be problematic in some jurisdictions. Mr. Winetroub agreed, noting that this was one reason that the IESBA had not proposed an absolute prohibition.

Mr. Winetroub thanked the CAG members for their comments.

#### **D. Drafting Conventions**

Mr. Dakdduk, Drafting Conventions Task Force Chair, introduced the topic. He noted that 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. He noted that to date, 47 response letter had been received.

Mr. Dakdduk indicated that the Task Force had not yet had the opportunity to carefully consider all the comments that had been received. He indicated that the matters that would be presented had not yet been discussed with the Board. They represented the Task Force's preliminary views.

##### *Key Drafting Convention Change "Should" to "Shall"*

Mr. Dakdduk reported that the exposure draft proposed changing "should" to "shall" in most parts of the Code. "Shall" is intended to more clearly convey a requirement. The exposure draft also stated that compliance with a specific provision that uses "shall" is mandatory unless compliance is prohibited by law or regulation or an exception to compliance is permitted by the Code.

The majority of respondents to the exposure draft were supportive of the approach proposed. These respondents felt that this strengthens the Code and enhances its clarity. Respondents also noted that this will bring the drafting of the Code in line with the approach taken in the ISAs. Some respondents expressed general support for the change from "should" to "shall" but were of the view that either some additional paragraphs should use the term "shall" (for example, paragraph 100.5, which states "a professional accountant is required to comply with the following...").

A minority expressed concern with the approach. Some respondents felt that the approach moves the Code further away from a principles-based approach. Other respondents were concerned that the approach reduces the need to apply professional judgment. It was also noted that some of the new "shalls" may impose new requirements or requirements that are unnecessary.

Mr. Dakdduk reported that the Task Force had discussed the comments and was of the preliminary view that the approach was appropriate, believing that concern about moving away from a principles-based approach was outweighed by the benefits of enhanced clarity and a stronger Code. With respect to the comments about each requirement containing the word "shall". The IESBA had been of the view that if it was clear from the existing wording that a requirement existed it was not necessary to re-write that

requirement to use the word “shall”. Reflecting on the respondents’ comments, the Task Force recognized that, without consistency, some may feel that if different words are used a different meaning was intended. The Task Force was, therefore, of the preliminary view that all requirements should be expressed using “shall”. With respect to the concern that some of the new “shalls” create new or unnecessary requirements, the Task Force plans to review the Code to determine if each requirement is appropriate. With respect to the concern about reducing the need to apply professional judgment, the Task Force will consider this issue as part of the consideration of comments on the exception clause.

Ms. Koski-Grafer expressed support for the use of “shall”. She noted that at the IAASB there had been significant debate regarding each use of the word “shall” resulting in re-examinations of substance and some provisions ending up as requirements and others being “demoted” to guidance or being removed. She stated that it would, therefore, seem to be a good idea to have a final careful review of the Code to ensure that each use is communicated as appropriate and intended by the IESBA.

Mr. Pickeur questioned the use of the phrase “shall not knowingly” noting that some “shoulds” had been changed to this construct. Mr. Dakdduk responded that the Task Force had not yet considered this comment.

Ms. Sucher noted that depending on the outcome of the exercise of re-considering the “shoulds” it might be necessary to consider whether re-exposure was necessary.

#### *Structure of the Code*

Mr. Dakdduk reported that the exposure draft asked respondents to comment on the IESBA’s view that separately presenting the objective to be achieved, the requirements designed to achieve that objective, and the application guidance as in the ISAs would not further improve the clarity of the Code. The majority of respondents were supportive of the approach proposed in the exposure draft. Some respondents noted that while the revised structure of ISAs may better suit standards that deal with procedures basically performed by professional accountants, such a structure would not suit a principles-based Code primarily dealing with professional behaviour. It was also noted that additional drafting conventions implemented by the IAASB would not further improve the clarity of the Code but would likely make the Code lengthier, which could make it more difficult to apply. A minority of respondents did not support the approach. These respondents expressed the view that separation of requirements and guidance would make the requirements clearer and would make the Code more readable. It would also contribute to a more uniform implementation of the Code into national regulation. One respondent indicated support for the structure in the short term but stated that more needs to be done to help users identify the requirements in the IFAC Code.

Mr. Dakdduk reported that the Task Force had considered these comments and was of the preliminary view that the approach in the exposure draft was appropriate and a change in structure could be viewed as weakening the Code.

Ms. Koski-Grafer expressed the view that the present structure was appropriate for this project but wondered whether it was something that should be considered more fully in the longer term. She observed that the Code overall seemed very long and wondered if another approach could simplify or clarify it further. Mr. Dakdduk stated that a section of the Code had been re-written under all of the IAASB clarity conventions and the result had been that separating requirements and application material would either result in a longer document (because of the need to repeat the requirements) or a weaker document (because of a reduced number of requirements).

#### *Exception clause*

Mr. Dakdduk reported that the exposure draft contained an exception clause. He noted that the IESBA had recognized that there were implications when “shall” conveys an absolute requirement. Without some exception it might not fit comfortably within a principles-based Code because it might eliminate the need for professional judgment. In addition, it could have unintended consequences in catastrophic situations and it is also not possible to anticipate all circumstances that a professional accountant could face. Mr. Dakdduk stated that the exception clause that was contained in the exposure draft enabled a professional accountant, provided certain conditions were met, to choose an alternative approach if that approach was in the public interest. The IESBA was of the view that such an exception promotes the exercise of professional judgment in exceptional circumstances and is consistent with a principles-based Code. The explanatory memorandum to the exposure draft stated that it was not possible to anticipate all circumstances where specific exceptions might be appropriate. The Code currently contains two exceptions in the area of partner rotation and bookkeeping/accounting services. In addition, the ISAs provide for a departure from a requirement denoted by “shall” in certain circumstances.

Mr. Dakdduk reported that the majority of respondents supported the inclusion of a provision that permits an exception, though a significant minority disagreed with the inclusion of the exception clause. In addition, several of those who supported an exception disagreed with how the exception was drafted. Those that supported the inclusion of a clause agreed with the position stated in the explanatory memorandum that it was not possible to anticipate all circumstances that might be faced by a professional accountant. Those who disagreed with the clause expressed the view that such a clause would weaken the Code and undermine its requirements. Some respondents also expressed concern that an exception clause may be abused.

Mr. Dakdduk reported that the Task Force’s preliminary thinking was that majority of the respondents were supportive and that concerns about the potential weakening of the Code would be addressed through changes to the drafting of the exception clause.

Mr. Dakdduk reminded the CAG that the proposed exception clause provided that it would apply only in exceptional and unforeseen circumstances outside the control of the accountant, firm and client, in those situations where complying with a requirement of the Code may result in an outcome that would not be in the interest of users of the output

of the professional services. In such situations a departure would be acceptable only if all of the following conditions were 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.

#### Position of paragraph

Many respondents expressed the view that the clause seemed to apply only to independence. These respondents, therefore, felt the clause should be moved to Sections 290 and 291. Mr. Dakdduk reported that the Task Force had considered this matter and its preliminary thinking was that the paragraph was necessary to address independence issues. The Task Force reviewed the remainder of the Code and did not identify a circumstance where an exception would be necessary. The Task Force's preliminary view was, therefore, that the paragraph be moved to sections 290 and 291.

Ms. Koski-Grafer expressed the view that while this seemed to be a reasonable approach with respect to the position of the paragraph, positioning the clause at the front of the Code could be seen by some as providing an exception enabling an accountant to depart from a fundamental principle.

Ms. Blomme indicated that the approach might be problematic for public accountants in business and posed the question whether there should be some similar exception clause in, for example, Section 300. Mr. Dakdduk indicated that some respondents to the exposure draft had questioned Section 300 and the Task Force intended to carefully review the section for the use of shall.

#### Scope of paragraph

Mr. Dakdduk stated the Task Force considered the comments of those who expressed concern that the proposed approach would be seen by some as weakening the Code. The Task Force's preliminary thinking was that a reasonable and informed third party would conclude that application of a specific requirement was not appropriate only in circumstances where independence was not compromised – for example, because the accountant was able to apply alternative safeguards. The Task Force's preliminary view was, therefore, that before the accountant could take an action that was other than an action specifically required by a provision in the Code, the accountant would have to conclude that independence would not be compromised by taking the alternative action.

#### Unforeseen circumstances outside the control of the relevant parties

Mr. Dakdduk reported that many respondents expressed the view that it was not necessary that the circumstances giving rise to the need for an exception be unforeseen. In addition, several respondents expressed the view that it was not necessary that the circumstances be outside of the control of the accountant, firm and client. These respondents noted that such a test would seem to unfairly punish an audit client that acquires an entity to which the firm is rendering a non-assurance service that would be prohibited if provided to an audit client. In addition, the critical test should be whether the exception is in the public interest. Mr. Dakdduk reported that the Task Force had considered these comments and its preliminary view was that, because of the proposed additional test that independence not be compromised, the criteria of unforeseen and outside of the control of the relevant parties were not necessary.

#### Disclosure to users of the service

Mr. Dakdduk reported that many respondents expressed concern with the proposal that the nature of the departure, and the reasons for the departure, be disclosed to users of the output of the professional services. The respondents noted that:

- It was unnecessary given other conditions and would undermine the credibility of the audit report;
- Disclosure of the nature of the departure and the reasons for the departure could, in certain cases, be interpreted by the wider public as constituting a statement that the professional accountant had not complied with the Code of Ethics, which would not be the case, nor would it be in the public interest; and
- It is unclear who would be the “users” and, in the case of a public interest entity, it may be impossible for the accountant to identify all of the users.

Mr. Dakdduk stated that the Task Force considered these comments and its preliminary view is that it is not necessary to require disclosure to the users of the output of the professional services.

#### Discussion with relevant regulatory authority

Mr. Dakdduk reported that the exposure draft stated that the accountant might wish to discuss the matter with the relevant regulatory authority. Some respondents expressed the view that the accountant should be required to discuss the matter with the regulatory authority. The Task Force considered these comments and also reflected on the concern, expressed by some, that the exception could be seen as weakening the Code. The Task Force was of the preliminary view that, in the case of a public interest entity, the matter should be discussed with a relevant regulator and, if no such regulator was available, the matter should be discussed with a member body. In the case of an audit client that is not a public interest entity the matter should be discussed with the relevant member body. Mr. Dakdduk noted that the Task Force recognizes that this would mean when there is neither a regulator nor a member body with whom to discuss the matter, a departure is not possible.

Mr. Damant noted that requiring discussion with a regulator when dealing with a public interest entity should reduce the concern over abuse. Mr. Dakdduk agreed and noted that the preliminary view was that, in the case of non-public interest entities, discussion with a member body would be required.

Mr. Sylph asked whether the Task Force has considered whether this principle could be applied in all jurisdictions, noting that, in some jurisdictions, a regulator might not be able to respond quickly. Mr. Dakdduk stated that the current view of the Task Force was that in order to be able to apply the exception the accountant would need to form a conclusion and have the discussion with either the regulator or the member body. The Task Force did not anticipate that a regulator would give formal approval of the exception, rather there would be a dialogue and the regulator would state no objection.

Mr. Koktvedgaard questioned whether it would be problematic if a regulator was unable to respond for a long period of time. Mr. Dakdduk agreed that an alternative course of action might need to be taken while the regulator considers the matter.

Ms Blomme questioned whether the Task Force's preliminary thinking could put the regulator and the member body on equal footing. If this were the case, the accountant could consult with a member body in those cases where timely consultation with the regulator was not possible. Mr. Dakdduk responded that the preliminary view of the Task Force was that this would not be strong enough in the case of public interest entities. The Task Force was of the view that if there is a regulator, the discussion should be with that regulator. Mr. George concurred noting that the clause was providing an exception to compliance with a requirement in the Code.

Mr. Haaning stated that the requirement can be seen as a safeguard and as a way of getting the matter into the open. He questioned whether the requirement should be to "inform" the regulator. Mr. Dakdduk responded that he would interpret "inform" as a one way communication and what the Task Force had in mind was a two-way dialogue/discussion. The Task Force was of the view that this was necessary for the accountant to obtain an understanding of the views of the regulator.

Ms. Koski-Grafer noted that regulators would expect accountants to have thought through the issues before starting the discussion.

Mr. Pickeur expressed the view that it would be useful if there was some reference to the discussion with the regulator being on a "timely basis."

Ms. Koski-Grafer stated that regulators in different jurisdictions might have different views as to whether consultation with the regulator should be a requirement. Using the example of a technical violation where the audit firm discovering the violation might believe and would wish to argue that independence had not been compromised, she stated that in the US this would typically be discussed with the SEC staff to identify the resolution needed. However, discussions within IOSCO had indicated not all regulators in all countries would be in a position to handle an ongoing volume of such inquiries or

would consider that an appropriate role for the securities regulator, and would therefore expect them to be handled in a different way

#### Disclosure to users of the service

Mr. Dakdduk reported that many respondents expressed concern with the proposal that the nature of the departure, and the reasons for the departure, be disclosed to users of the output of the professional services. The respondents noted that:

- It was unnecessary given other conditions and would undermine the credibility of the audit report;
- Disclosure of the nature of the departure and the reasons for the departure could, in certain cases, be interpreted by the wider public as constituting a statement that the professional accountant had not complied with the Code of Ethics, which would not be the case, nor would it be in the public interest; and
- It is unclear who would be the “users” and, in the case of a public interest entity, it may be impossible for the accountant to identify all of the users.

Mr. Dakdduk noted that the Task Force considered these comments and was of the preliminary view that it was not necessary to require disclosure to the users of the output of the professional services. In addition, the Task Force notes that if an exception is to be permitted only if independence is not compromised it would not be necessary to disclose the departure.

Ms. Koski-Grafer observed that disclosure to general-purpose users would not be particularly helpful in that it could create uncertainty and confusion over whether the audit was acceptable or not.

#### Other comments

Ms. Koski-Grafer noted that it would be useful to state that the exception clause was for “rare” circumstances. Without such a qualification, she noted that “exceptional” could be interpreted as merely “other than usual” and this would be problematic, possibly allowing frequent exceptions. She stated that if “exceptional” was to be retained, the Code should provide guidance on the intended meaning of “exceptional”.

Mr. Fleck noted that there were alternative courses of action available to the firm in several of the examples that had been provided, for example, obtaining the assistance of another firm. While he recognized that it would be useful to address client mergers and acquisitions he felt that it would be necessary to look at specific examples of other situations to determine whether a general exception clause was necessary. Mr. Dakdduk responded that the discussion with a regulator might indicate that the necessary step was to obtain the assistance of another firm. Mr. Fleck noted if that was the case, the exception clause was not necessary because the situation would be resolved. On the other hand, if the regulator expressed the view that the situation was untenable, the firm would not continue as auditor and again the situation would be resolved. Ms. Koski-Grafer noted that even if the regulator agreed that obtaining the assistance of another firm

resolved the issue, the auditor would still need to be independent to issue the audit report which, therefore, would indicate that an exception clause was appropriate.

Mr. Haaning stated that some regulators might find an exception clause in the Code useful because it would enable them to have a discussion with the firm with the view to seeking resolution of the issue.

Ms. Sucher stated that she was concerned about an exception. She noted that it seemed counter intuitive to have a Code that explains what is required and the immediately states that an exception was provided.

Mr. Pickeur noted that the regulator is the guardian of the public interest. He expressed the view that a requirement that the regulator be “informed” would not be helpful and what was necessary was that there be a two way dialogue and discussion. Mr Haaning agreed with Mr. Pickeur, noting that the discussion with the regulator was a safeguard. He also emphasized the importance of documenting the discussion.

Mr. Haaning expressed the view that independence is closely related to integrity and objectivity. Mr. Fleck questioned whether the clause was necessary. The Code requires the accountant to comply with the fundamental principles. If the accountant does not comply with one of the specific requirements he or she still has to be in a position to comply with the fundamental principles. The test is, therefore, whether objectivity is maintained. Mr. Dakdduk responded that the issue is created by the mandatory nature of “shall”. Mr Sucher noted that if the requirement was only for objectivity it would not be necessary to have the detailed requirements in the Code.

Mr. Fleck questioned whether it might clarify matters if the exception clause was considered in three categories:

- Category 1 – situations where an departure from normal requirements was needed because of force majeure such as a natural disaster or a terrorist act;
- Category 2 – situations dealing with mergers and acquisitions; and
- Category 3 – all other situations.

Mr. Dakdduk noted that the category 1 situations were unique. He also noted that there was evidence that in the case of such an event regulators and member bodies had recognized the need for the departure and provided guidance that supported an alternative action.

Mr. Fleck noted that an alternative would be to deal with this category through a footnote. Ms Koski-Grafer noted that the Code was not written to contemplate such events and perhaps this could be addressed in a similar manner to scope paragraphs in accounting standards (This Code does not provide guidance for...). Mr. Fleck responded that this approach would be a better solution.

With respect to category 2 situations, Mr Fleck noted that the APB provides for a transition to allow the firm to complete the service rather than providing an exemption.

Mr. Dakdduk noted that a “transition clause” could sound a little more permissive than an exception clause. Mr. Fleck noted that mergers and acquisitions are not exceptional; they are common occurrences and it might be useful to provide specific guidance to address such circumstances. He noted that it would be important that the guidance be principles-based and capable of addressing differing environments.

Ms. Koski-Grafer stated that she found the three categories helpful as a way of conceptualizing the matters to be addressed. She noted that she had heard several examples of unusual types of events that would perhaps fit into the category 3 in discussions raised by audit firms with her colleagues on the SEC staff. She noted, however, that the Code already contains relief for some circumstances and relief based on materiality thresholds whereas her jurisdiction does not have a materiality exception, so the experiences might not be generalizable to a global Code.

Ms. Sucher stated that if mergers and acquisitions was the main area where some accommodation or guidance was necessary then perhaps that should be the focus of the exception clause, rather than also trying to address the wider category 3.

Mr. Pickeur stated that it was important that the exception, if any, was clear and not overly complicated.

*Clearly insignificant and documentation*

Mr. Dakdduk reported that the majority of the respondents were supportive of the proposed change to remove the reference to “clearly insignificant” in relation to the identification of threats and application of safeguards. Respondents agreed that the existing interaction of “clearly insignificant” and “acceptable level” has the potential to create ambiguity. A minority of the respondents felt that the current documentation requirement in the Code should be strengthened to require documentation of the professional accountant’s assessment of independence and also to require documentation of threats that, while at an acceptable level, were “close to the margin” (i.e. just below an acceptable level).

The Task Force had considered the comments received and proposed that documentation requirement be revised to read:

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. When threats are identified that require the professional accountant to determine whether safeguards are necessary to reduce them to an acceptable level, the professional accountant shall also document the nature of those threats and safeguards, if any, applied.”

Ms. Koski-Grafer stated that the requirement could refer to “whether or not safeguards were ultimately judged to be necessary.

Ms. Sucher stated that the revision was preferable to the previous language which had seemed to be somewhat defensive. She noted that it might be useful to add a requirement that the accountant document the rationale for the conclusions. Mr. Dakdduk responded that while he thought the need to document the rationale was implicit the Task Force would consider this matter.

Mr. Fleck thanked Mr. Dakdduk for the clarity of the discussion.

Ms. Koski-Grafer noted that the agenda papers seemed to provide mostly numerical summaries of responses and did not seem to give any specific recognition to comments from public interest respondents. She questioned whether there was enough coverage given by the Board to the comments of regulators, even though they might be a minority in number, if they were not specifically identified in agenda papers made available to the Board. Mr. George stated that all comments are carefully considered and the Board is especially interested in the comments from public interest members.

#### **E. Review by Monitoring Group**

Mr. Sylph provided an update of the review to be undertaken by the Monitoring Group. He noted that as part of the IFAC reforms, the Monitoring Group was charged with conducting a review within five years and the Monitoring Group had decided to conduct the review before the five years had elapsed. The review was not a crisis review because of perceived problems; rather his understanding was that the Monitoring Group had a high degree of favourable feeling related to the workings of the PIACs and their CAGs. He noted that there have been many changes in the environment in the last few years. These changes include, for example, changes in mechanisms of oversight for member bodies and for adoption of standards. It was, therefore, viewed as an opportune time to consider whether the IFAC standard setting process that had been in place for the past few years would continue to be appropriate for the next five years. Mr Hegarty will chair the review.

Mr. Sylph further reported that he expects that review will include the development of criteria for the measurement of the success. He expected the proposals would be the subject of significant disclosure in 2009, likely using the existing consultation processes of the Monitoring Group members. The current expectation is that the Monitoring Group will complete its review by Q4 2009 or Q1 2010.

#### **F. Closing**

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

#### **G. Future Meeting Dates**

September 9, 2009 (Washington DC, USA)