



International Organization of Securities Commissions  
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2 May 2013

Mr. Jörgen Holmquist  
Chair  
International Ethics Standards Board for Accountants  
529 Fifth Avenue, 5<sup>th</sup> Floor  
New York, NY 10017 USA

Our Ref: 2013/JE/C1/IESBA/75

**Subject Line: IESBA 2014-2016 Strategic Review Survey**

Dear Sir:

The International Organization of Securities Commissions' Committee on Issuer Accounting, Audit and Disclosure (Committee 1) appreciates the opportunity to provide the International Ethics Standards Board for Accountants ("IESBA") with comments for the Board's 2014-2016 Strategic Review Survey for your consideration. As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing and professional standards.

Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting, auditing and disclosure concerns, and pursuit of improved global financial reporting. Unless otherwise noted, the comments we have provided herein reflect a general consensus among the members of Committee 1 and are not intended to include all comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

**Focus of the Board's projects**

Confident and informed markets and investors rely on quality financial reports. The quality of financial reports is supported by the quality of independent external audits.



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Accordingly, we believe it is important that the IESBA should continue to focus on improving the “Code of Ethics for Professional Accountants” (“the Code”), particularly in relation to auditor independence for public interest entities.

### **Need for improvements to the Code**

International convergence of auditor independence requirements has potential benefits for the audit profession, users of financial reports and companies and therefore we are supportive of continual efforts to enhance and improve the Code. The IESBA should consider ways to improve the Code to better meet the needs of markets and investors. This may involve further consideration by the IESBA of regulatory requirements in large jurisdictions that could be reflected in the Code.

While recognizing that a number of improvements have been made to the Code in recent years, there are opportunities for further improvements to the auditor independence requirements.

The Code appears to reflect a number of compromises to address perceived practical issues in some, particularly smaller, jurisdictions. The Code should have regard to potentially higher thresholds set by users of financial reports and users of accounting/audit services in the more developed capital markets where perhaps fewer practical, situational considerations are involved.

We are concerned that the Code may adopt a lowest common denominator approach that is not appropriate for public interest entities. For example, as discussed later in this letter, it is unclear why there is a need for independence to be compromised by allowing auditors to provide record keeping for public interest entities, even in emergency situations.

There are opportunities for further improvement in the proposed Code. Our specific comments follow based on what our members have uncovered in working with the Code.

### **Part 2: Possible Future Projects**

#### **Safeguards**

The Code allows threats to independence to be disregarded if the auditor puts in place specified safeguards. However, many safeguards are inappropriate or ineffective. Some safeguards merely duplicate existing requirements imposed by the quality control and auditing standards or the existing best practice for situations that don’t involve a threat to independence. In these cases, the Code



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should specify additional safeguards or remove inappropriate safeguards and specify that the situation is not acceptable.

As an example, paragraph 290.107 permits an audit firm retirement plan to hold a direct or indirect financial interest in an audit client provided safeguards are in place to reduce any threats identified to an acceptable level. We do not believe that there can be any safeguards to mitigate the threat to independence.

### **Longstanding associations**

#### Rotation of team members

Paragraphs 290.151 to 290.155 of the Code permit the key audit partner to play a significant role in an audit for up to 7 years. The IESBA should review this period given the shorter regulatory requirement of 5 years for public interest entities in many jurisdictions. A 5 year rotation period would ensure auditors that a fresh mind is brought to the audit more frequently and reduce any familiarity threat.

Paragraph 290.154 of the Code permits a key audit partner who has already served for six or more years when the audit client first becomes a public interest entity to continue to serve in that capacity for an additional two years. We believe that the focus should be on the current status of the entity and the total length of the relationship. On this basis, the maximum period should not be extended when an entity first becomes a public interest entity.

There should also be maximum terms for other senior members of the audit team and for entities controlled by public interest entities.

#### Firm rotation

The IESBA should monitor developments in relation to audit firm rotation in the EU and the US.

### **Non-audit services**

The IESBA should review the types of non-audit services that an auditor may provide to public interest entities to reconsider whether the auditor's performance of such non-audit services has an inappropriate influence on the auditor's objectivity and independence in conducting the audit of the entity.



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### **Definition of “Public Interest Entity”**

The IESBA set a minimum definition of “Public Interest Entity”, which was to be reviewed for application of the independence requirements in each jurisdiction. Some countries have accepted the minimum definition in the Code without amendment. The Code presumes that regulators can set a definition but regulators do not have the power to set requirements in many jurisdictions.

We believe that the IESBA should consider aligning the term “public interest entity” with the term “public accountability” in the International Financial Report Standards (“IFRS”). Public accountability concerns entities filing financial reports with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market, or holding assets in a fiduciary capacity for a broad group of outsiders.

Consistency in the approaches between the proposed Code and the accounting standards will be simpler and may reduce any possible confusion amongst auditors and audit clients in jurisdictions that use IFRS.

### **Breaches**

We appreciate the efforts of the IESBA to review the “inadvertent violation” exemptions in the IFAC Code and to introduce a new approach to dealing with breaches. We believe that the IESBA should consider further opportunities to improve the Code in relation to breaches, including:

- (a) Clearly defining what the term “significant” means including what bench mark is to be used to measure the significance of a breach;
- (b) When it is appropriate for an auditor to take action to address the consequences of a breach of the independence requirements rather than resign; and.
- (c) Working with the IAASB on public reporting of an auditor’s compliance with the Code through the audit report, including reporting of breaches.



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### **Part 3: Adoption and Implementation**

#### **Clarity format**

We believe that the IESBA should adopt a “clarity” format for the Code to provide clear mandatory objectives and a clear distinction between mandatory requirements and application guidance. The “clarity” format would also consistently use unequivocal language such as “shall” rather than “should”. This approach would ensure that the obligations of an auditor or an accountant are clearly communicated.

#### **Enforceability of the Code**

As securities regulators, we have concerns with the inability to enforce the Code due to, among other matters, the lack of precision of various requirements throughout the Code and the flexibility for auditors to exercise significant judgment in complying. We believe the Board should review the requirements within the Code to enhance the Code’s enforceability by securities regulators.

### **Part 4: Convergence**

None noted.

### **Part 5: Any Other Matters**

#### **Fee dependence**

The safeguards for fee dependency do not appear to be commensurate with the potential threats to independence that the Code seeks to prevent. In particular, the Code should:

- (a) Outline circumstances where the auditor is required to decline an engagement as a safeguard to eliminate any self interest or intimidation threat that may arise from significant fee dependency. Paragraphs 290.221 to 290.223 do not require an auditor to decline an engagement;
- (b) Require an external review from the outset, not just in the second or subsequent year audits. The requirement for an Engagement Quality Control Review to be performed on a listed engagement prior to the issuance of an audit opinion is an existing requirement of the auditing



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standards and does not provide any additional safeguard against fee dependency for public interest entities;

- (c) Require pre-issuance reviews in all instances as post-issuance reviews are a detective measure rather than a preventative measure; and
- (d) Include quantitative guidance as to the level of acceptable fees for non-public interest entities.

In addition, the level of non-audit services provided to audit clients may threaten independence but this is not considered in the Code. The Code should include guidance in relation to when the quantum of non-audit services may threaten independence.

#### **Emergency situations and other exemptions**

The IESBA should consider removing the exemption for providing accounting and bookkeeping services and preparation of tax calculations in "...emergency or other unusual situations when it is impractical for the Audit Client to make other arrangements" in paragraphs 290.172, 290.174, 290.185 and 290.186 of the Code.

This exemption creates a self-review threat and undermines the purpose of an independent audit. The exemption is unnecessary given that there are relatively large numbers of qualified accountants in most jurisdictions who could be engaged to provide those services other than the auditor.

We have significant concerns with such an exemption for any entities and, in particular, public interest entities.

The Code should be reviewed in detail for other inappropriate and unnecessary exemptions.

#### **Business, employment and financial relationships**

The IESBA should consider the need for prohibitions on business, employment and financial relationships between auditors and their audit clients.

The IESBA should also consider whether changes should be made to the Code to:

- (a) Extend the 12 month cooling off period for retiring audit partners that join an audit client that is a public interest entity to 2 years (paragraphs 290.139 and 290.140); and



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- (b) Require a 5 year cooling off period before a former partner of the firm can become an officer or director of an audit client, when another former partner of the firm at the time when the firm audited the client is an officer or director of the client.

### **Internal audit services**

#### Direct assistance

The IESBA should further consider how auditors use internal auditors as part of the external audit work. Even with review of the internal auditor's work and other safeguards, the internal auditor is an employee of the entity and some of our members believe employees should not be part of the external audit process. Review of internal audit reports and work as part of the risk assessment and as part of a company's system of internal control is a different matter.

#### Other matters

The Code should be amended to prohibit the auditor from providing internal audit services where there is any self-review threat, not only where management functions are assumed. Consideration should be given to prohibiting internal audit services despite the provisions in paragraph 290.198 given the remaining self-review threat and the perception of a lack of independence.

Further, what constitutes "internal audit" and the distinction from similar other services should be more clearly defined (paragraph 290.195 of the Code). Equivalent services that are not labeled as internal audit services should be treated in an equivalent manner in the Code.

### **Materiality**

The proposed Code applies to material contraventions and should provide guidance on how to evaluate materiality.

The IESBA should consider whether the following arrangements not be permitted by the Code irrespective of materiality and significance:

- (a) A firm, a member of the audit team or a member of that individual's immediate family may make or guarantee a loan to an audit client, provided the loan or guarantee is immaterial to the firm or individual and the client (paragraph 290.122); and



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- (b) A firm, or a member of the audit team, or a member of that individual's immediate family may enter into certain business relationships with the audit client or its management and hold a financial interest arising from such relationships provided the financial interest is immaterial and the business relationship is insignificant to the firm and the client or its management (paragraphs 290.124 and 290.125).

These exemptions may lead to unnecessarily difficult judgments by auditors.

#### **Documentation**

The documentation requirements in paragraph 290.29 of the Code should apply to any threats to independence requiring analysis and not only those requiring significant analysis.

There should be consistency between the general documentation requirement in paragraph 290.29 and the specific documentation requirements in other paragraphs of the proposed Code. For example, in relation to mergers and acquisitions, paragraph 290.38 only requires documentation of certain interests and/or relationships which have not been successfully terminated by the effective date of the merger or acquisition for situations described in paragraphs 290.34 to 290.36. All instances requiring analysis should be documented.

#### **Other assurance engagements**

Some of the comments above may also apply to equivalent sections of the proposed Code dealing with Other Assurance Engagements.





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Thank you for the opportunity to provide input on this project. If you have any questions or would like to further discuss the matters noted in this letter, please contact either Nigel James or me at 202-551-5300.

Sincerely,

Julie A. Erhardt  
Chair  
Committee 1  
International Organization of Securities Commissions