Organización Internacional de Comisiones de Valores
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July 12, 2007

Ms. Jan Munro
Senior Technical Manager
International Ethics Standards Board for Accountants
International Federation of Accountants
545 Fifth Avenue, 14th Floor
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Email address: Edcomments@ifac.org

Dear Ms. Munro:

Re: Exposure draft of Sections 290 and 291 of the International Federation of Accountants (IFAC) Code of Ethics for Professional Accountants, *Independence –Audit and Review Engagements and Independence – Other Assurance Engagements*

IOSCO Standing Committee No. 1 on Multinational Disclosure and Accounting ("SC 1") appreciates the opportunity to comment on the exposure draft of proposed Sections 290 and 291 of the Code of Ethics for Professional Accountants ("Code" or " Ethics Code").

As an international organization of securities regulators representing the public interest, IOSCO SC 1 is committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing, and professional standards. Members of SC 1 seek to further IOSCO's mission through thoughtful consideration of accounting, auditing and disclosure concerns and pursuit of improved global financial reporting. As we review proposed auditing, ethics and independence standards, our concerns focus on whether the standards are sufficient in scope and adequately cover all relevant aspects of the subject area being addressed, whether the standards are clear and understandable, and whether the standards are written in such a way as to be enforceable.

Our comments in this letter reflect a consensus among the members of SC 1; however, they are not intended to include all comments that might be provided by individual members on behalf of their respective jurisdictions.

The Exposure Draft is a demonstration of directional progress but the Code needs to be clarified and further improved

We believe that a number of the proposed specific revisions to the Code represent progress in the right direction. They address some of the areas that have been the subject of scrutiny by securities regulators and others. However, we also believe the proposed Code is in need of

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significant clarification and needs to be further improved in certain subject areas addressed in the ED and in other areas.

As the Code's independence standards for audits of public listed companies are of high interest to IOSCO securities regulators, we appreciate that the IESBA has encouraged feedback on further improvements needed in the Code as part of the exposure draft comment process. Our comments regarding the proposed changes in the Exposure Draft and other general improvements needed are in the main body of this letter. These main letter comments are followed by two Appendices providing additional comments and suggestions for further improvement in the Code, and our responses to questions in the Exposure Draft.

In regard to the overall tone and clarity of language in the Code, further improvement is needed

As one reads through the Ethics Code, the impression that arises is that despite the specific improvements that the IESBA is proposing at this time, the overall tone of the Code is still not direct and active, and that the Code is not always clear about what is intended. The proposed standard is very long and sometimes difficult to read. The language used is sometimes indirect, and ambivalent or weak. Threats to independence are not always clearly stated. In general, our view is that the Code is less clear and less enforceable than the ISAs, both in structure and in language, and that the Code would benefit from significant work to improve its overall clarity. In describing a threat, even one recognised as being so significant that there are no appropriate safeguards to mitigate it, the Code as written today usually qualifies the description by using the verb "may" -- in statements such as "these circumstances or services may create a threat..." To strengthen the Code, we believe the language used should be made more direct, such as by saying that "such circumstances or services create a threat". For example, we refer to paragraph 290.101, which states that "Holding a financial interest in an audit client may create a self-interest threat." We think it is definite and self-evident that holding a financial interest in an audited company creates a self-interest threat.

There is a need to differentiate between "safeguards against a threat" and "elimination of a threat"

We consider safeguards to be appropriate in circumstances where the safeguard provides a reasonable basis for a third party to conclude that the auditor's independence in fact or appearance has not been impaired. We make a distinction between "safeguards against a threat" and "steps to eliminate a threat." We observe that the Code provides two safeguards that we consider are more properly described as steps to eliminate the threat: (1) removal of the member from the audit team and (2) disposal of the financial interest.

The characterization of steps that *eliminate* a threat as a safeguard *for* a threat can generate confusion, as it reinforces the message that there are safeguards to most threats regardless of type, instead of the message that certain threats cannot be mitigated by appropriate safeguards. We recommend greater emphasis on identifying threats that can not be mitigated by safeguards and specifying the actions to be taken to address such threats, for example, as in the case cited in paragraph 290.182, "where the effectiveness of certain tax advice depends on a particular accounting treatment or presentation in the financial statements." It is helpful that here the Code clearly concludes that "no safeguards could reduce the threat to an acceptable level" and thus such a service could not be provided unless the firm were to withdraw from the audit engagement.

To provide a clear explanation, it is important that the Code distinguishes between actions taken to eliminate a threat (for example by prohibiting a specific service or arrangement) from

safeguards put in place to guard against threats related to a specific service or arrangement. Language that is more direct would improve the effectiveness of the Code.

Definitions – It is important to have conformity between the Ethics Code and the ISAs

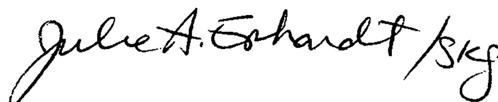
We think it is essential that the IESBA works with the IAASB to ensure that the definitions used in the Code for such matters as "audit engagement team" and "outside expert" are identical with similar definitions in ISA's. Where different concepts are appropriate, different nomenclature should be used to avoid confusion. We are concerned by apparent differences or conflicts between the way that the engagement team and outside experts will be treated in the Ethics Code and the ISAs.

We agree that the definition of an engagement team should not include outside experts in different areas of expertise that are contracted by the firm solely to supply an expert opinion from that different professional speciality. Other professions often have their own highly-developed codes of professional conduct, and we believe the auditor must consider facts and circumstances and the significance of the matter that the expert opinion is on in relation to the audit. As we read the Exposure Draft, it is not fully clear in the proposed Code what is meant by "services that otherwise might be provided by a partner or staff of the firm" in the instance where a firm may have some individuals on the payroll who provide legal expertise within the firm, but the firm's legal staff is not available and the audit engagement team therefore seeks and obtains a legal opinion on a matter from an external lawyer. In this case, is the advice from the external lawyer a service that might otherwise be provided by a partner or staff of the firm and therefore the provider of that advice is a member of the engagement team with auditor-type independence requirements? Alternatively, if the legal advice required is not in an area of speciality of the legal staff of the firm, but rather than undertaking in-house research in a new area, the firm's legal staff determines that it would be more efficient to use an external expert, does this advice fall under the definition of services that otherwise might be provided by the partner or staff of the firm?

We understand that the IAASB has a task force looking at the ISA on Using the Work of an Expert, and believe that the IESBA and IAASB should work closely together to ensure an appropriate interaction between the Code and all relevant ISAs, including the ISAs on Group Audits/Using the Work of Another Auditor and Using the Work of an Expert.

In conclusion, we wish to underline that establishing appropriate auditor independence requirements in the IFAC Ethics Code is important to auditors, investors, and issuers, including those charged with governance. A high quality independence and ethics code can help both to support investor confidence and to provide for appropriate audit firm choice in the capital markets. We encourage the IESBA to continue its important work on the Code and to address the issues we have raised in this letter. If the Board or staff would like to discuss any of these matters further with SC 1, they are invited to contact Susan Koski-Grafer at Koski-GraferS@sec.gov or any member of the SC 1 Auditing Subcommittee.

Sincerely,



Julie A. Erhardt
Chair
IOSCO Standing Committee No. 1

Appendix A - Other Comments and Suggestions for Improvement in the Code

Some safeguards specified in the Code are ineffective or of questionable effectiveness

In regard to paragraphs 290.28-290.30, we do not see how "obtaining the client's acknowledgement of responsibility for the results of a non-assurance service" subsequent to the audit firm having provided that service could be considered a safeguard. In our view, obtaining a client acknowledgment of responsibility could only be considered as a safeguard to the extent the client has acknowledged and taken responsibility on the front-end of the provision of the non-assurance service (not after the non-audit service has been provided, as implied by the wording in the current standard). The issuer would also have to continue to assume that responsibility throughout the course of the non-assurance engagement.

In another example, we refer to paragraph 290.146, where the Code states that a subsequent review by an additional professional accountant who was not a member of the engagement team may be a safeguard that could reduce a threat to an acceptable level. We question whether having a second professional accountant in the same audit firm or in another audit firm review the work of a person who is not independent (as opposed to having a review or inspection by an independent oversight body) is a sufficient safeguard in itself. Perhaps such a review may provide some limited comfort related to the work of the accountant that was not independent, and in conjunction with other safeguards could conceivably reduce a threat to an acceptable level in audits of non-public companies. But we consider this doubtful and are concerned that in some cases review by another professional accountant is the only safeguard proposed in the Code. This implies that reliance on another professional accountant's review is able to provide a much greater degree of comfort in an audit by a non-independent person than is warranted, and serves to undermine independence requirements.

Provision of non-assurance services to audit clients

We observe that certain requirements applicable to entities of significant public interest have been strengthened and that in many circumstances the IESBA has concluded that there were no safeguards available to overcome the threat to independence (e.g. 290.150). We appreciate this enhancement of the Code, as the areas involved have been the subject of concern among regulators, and encourage the IESBA to consider other enhancements that might be needed.

We encourage the IESBA to analyze and consider the findings of the IOSCO Survey on Regulation of Non-audit Services and use these findings to identify ways to improve the IFAC Ethics Code. This could be very helpful in moving toward greater global convergence in ethics and independence standards. SC 1's Auditing Subcommittee would be happy to discuss the results of the Survey with representatives of the IESBA Board and staff as needed.

We note that many requirements applicable to entities of significant public interest include both a "relevance" consideration (e.g. 290.167 or 290.173) and a "materiality" consideration (e.g. 290.178). In concept, we support the IESBA's use of both qualitative and quantitative criteria in determining safeguards that can be applied in certain specific situations; however, broad use of "materiality" as a threshold in the context of auditor independence requirements would be problematic to some of our members.

As materiality is a term or concept that has had a wide range of usages and meanings in standards, we believe it would be helpful for the Board to study requirements and independence issues arising in jurisdictions around the world and to explore alternatives for assuring the necessary independence of the auditor while recognizing both cost/benefit considerations and impacts on investor perceptions. Alternatives explored could include such possibilities as greater or lesser thresholds for materiality, materiality definition in the context

of auditor independence, whether it might be appropriate to establish a very low threshold below which an independence issue might be considered trivial or insignificant, and other ways to promote consistent application and convergence in ways that do not threaten adequate auditor independence.

We also suggest that the IESBA study whether creating a provision requiring the auditor to discuss both audit and non-audit services with those charged with governance and/or seek board or audit committee pre-approval of such services would be an enhancement to the Code.

The Code's content on rotation of audit personnel needs further consideration, on both a short term and a long term basis.

Short term

For the short term, what is intended by the proposed revision in the ED needs to be more clearly stated. In some portions of the Code, a detailed discussion of specific matters that follows a general beginning point or principle in the Code seems to wander away from or overshadow the original point, and as a result, obscures a good initial message. One example of this is the discussion on rotation of key audit partners (paragraphs 290.147 to 290.149) with respect to audits of entities of significant public interest. These paragraphs seem to imply that rotation is not expected for (1) key partners on audits of entities that are not of significant public interest or (2) senior audit personnel other than key partners on audits of entities of significant public interest. If that is the intent, the requirement should be made clear.

In the way that the Code is written now, one is left with a general impression that rotation only applies to entities of significant public interest as provided by paragraphs 290.147 to 290.149. As a familiarity threat could apply to audits of any entity, a question arises as to what applies to entities that are not of significant public interest.

Further on the subject of rotation, the message in paragraph 290.146 is that there is a threat to independence from long association of senior personnel, not just the audit partner; however, this point seems to be overshadowed by the discussion in the subsequent paragraphs, which seem to be contemplating some exceptions or lesser requirements with respect to these other types of individuals.

Long term

For the long term, we suggest that the IESBA consider undertaking a project to study the ways in which the auditor rotation requirements work in combination with other controls and checks and balances that have come to exist in some frameworks today and which also address the familiarity and other threats and audit quality assurance. It would be useful for the IESBA to perform research, or to commission research, on what, if any, effects on independence and objectivity have been observed from the inspection work of independent auditor oversight bodies. The IESBA could then identify if there seems to be any resulting implications for auditor professional standards.

While all rotation intervals are essentially arbitrary timing intervals designed to promote objectivity, we are concerned that the Code's currently proposed rotation requirements may not be sufficiently comprehensive to lead the way to greater global convergence over the longer term. Many jurisdictions have more stringent rotation requirements today and some currently have mandatory audit firm rotation requirements. Others such as the United States have a five and seven year rotation period based on a prescribed definition of "Audit Partner," addressing the Lead and Concurring Partners as well as audit partners responsible for significant consolidated subsidiaries and those in the chain of command.

On the other hand, some IOSCO emerging markets are actively engaged in building financial market infrastructure and have environments described as having very limited supplies of qualified audit personnel. It is asserted that such conditions make the auditor independence and rotation requirements of the more developed markets more difficult to maintain in practice in an emerging market situation. Still other jurisdictions have found it necessary and desirable to create exceptions to normal public company rotation requirement provisions for very small firms auditing very small public companies (e.g., Canada) or to provide alternative ways of addressing the familiarity threat in very small audit firms that audit only a few small public companies (U.S.)

In the interest of moving toward an international standard that could win global acceptance, it would be desirable for the IESBA to benchmark the requirements that regulators and oversight bodies have in place today and to commission research into the experience with independence requirements. It might also be helpful to study the interactions of regular inspections by independent oversight bodies with the auditor rotation requirements that predated the creation of such requirements, to identify the ways, if any, that audit inspections may be addressing familiarity threat issues.

We also believe it would be useful for the IESBA to enter into more extensive dialogues with regulators, users, and other stakeholders as to the prospects for developing a set of global standards that would be effective in addressing familiarity, self-review and other threats, yet recognize the challenges of countries with limited auditor supply and markets with a sizeable number of audits of very small public entities by small audit firms. Finding an effective way to address conflicting views and demands in professional standards, yet support appropriate independence and objectivity could help the IESBA to provide leadership. It could also serve to facilitate the ability for high quality audits to be conducted by a broader selection of audit firm choices for public interest entities.

Scope of section 290 – The range of auditor services that is intended under the category "Other Assurance Engagements" is unclear and the challenge of having two different standards seems to create greater complexity.

As securities regulators we believe that all assurance engagements involving listed companies should adhere to the same independence requirements, with the possible exception of restricted use reports provided to a non-audit client. We understand the perceived benefits of dividing the guidance into two areas in order to make it easier to apply the code in particular circumstances. However, we are unconvinced that the right place to draw the line is between audit and review engagements on the one hand and "other assurance" engagements on the other hand. As securities regulators we see no reason why "other assurance" reports from a professional accountant, that investors may rely on, should be subject to lower standards of independence than apply to the audited financial statements.

In some cases, as in the example of internal control reports by auditors in jurisdictions that require them, the auditor of a listed entity is responsible for non-audit assurance reports addressed to or for the benefit of investors. In these cases, it is important that the comfort that is provided by the higher standards of independence that are applicable to the auditor as the principal auditor of the financial statements apply to all "other assurance" engagements that he performs. There could also be "other assurance" engagements performed not by the entity's auditor of the financial statements that would broadly be for the benefit of investors.

We are concerned that creating multiple versions of the independence standards may add complexity for auditors, for those charged with governance, and for report users. Having one

standard, with some sub-points addressing certain types of engagements if necessary, could likely provide clearer understanding as to the required independence standards.

We are also concerned that the Code does not fully define or explain "other assurance" engagements or provide helpful examples of such engagements, nor are these types of engagements suitably explained elsewhere in the auditing standards. We anticipate that report users, practitioners and others will have difficulty sorting out which assurance engagements apply to Section 290 versus Section 291.

Restricted use reports coverage needs to be clarified

In the case of restricted use reports, we recognize than an entity engaging the audit firm generally defines the nature and scope of the engagement and that the users of such reports that are not audits of historical financial statements may be knowledgeable of their purpose and limitations. We are not opposed to having certain exceptions to prevailing independence standards specific to certain kinds of restricted-use reports, but we found the Code content in paragraphs 290.500 to 290.514 to be difficult to read and follow. The frequent and broad cross references and statements that seem to be effectively double negatives make it hard to follow what the Code is really intending for these types of engagements.

Networks and Network Firms (290.10-290.21)

The definition of networks and network firms seems very broad, and some of our members are concerned that it may be too broad, necessitating independence requirements where there is believed to be no issue of fact or appearance to investors that could undermine objectivity. Paragraph 290.11 says that whether a larger structure creates a network depends on the facts and circumstances – yet, the definition of "network" in the Code is very specific and leaves little room for consideration of facts and circumstances.

Based on the general presumption in paragraph 290.11, it would seem that a structure might not be a "network" if its purpose is only to facilitate the referral of work. But it is not clear whether a collection of firms would be part of a network if in addition to facilitating the referral of work, the firms utilize a name or logo for the larger referral and information sharing organization but do not co-operate in performing audits, do not share a quality control system, and do not share individual firm profits. Paragraph 290.18 makes reference to situations where firms do not use a common brand name in signing audit opinions but include a reference to a common referral association in stationery or promotional literature; however paragraph 290.18 does not provide guidance on the issues that such a firm might consider in order to determine whether it and the other entities in the organization would likely be viewed as a common firm by investors and regulators and thereby constitute a network for independence purposes.

There is also an interaction between the Ethics Code and ISAs in the matter of network firm definition. Where auditors follow the auditing guidance in the extant International Standard on Auditing 600, "Using the Work of Another Auditor", there could be circumstances and evidence whereby the firm affiliation under the network definition in that ISA would capture associations of firms where association-wide independence from all of each other's clients would not be needed.

Additional long term issues - the desirability of the IESBA working to develop concepts and definitions and other terminology that might over time receive greater global acceptance.

In some jurisdictions, the audit client definition includes a specific set of criteria for entities that are part of an "Investment Company Complex." We understand that the IESBA intends at some future date to consider whether the definition for "related entities" should include separate criteria for investment companies. We encourage the IESBA to pursue this issue, given the unique relationships that exist amongst entities affiliated with investment companies.

Appendix B - Responses to Specific Questions in the Exposure Draft

Q1. Is it appropriate to extend all of the listed entity provisions to entities of significant public interest? If not, why not and which specific provisions should not be extended? Is it appropriate that, depending on the facts and circumstances, regulated financial institutions would normally be entities of significant public interest and pension funds, government agencies, government-owned entities, and not for profit entities may be entities of significant public interest?

Response:

As securities regulators, our primary focus is on auditor independence as it relates to listed companies. We are pleased to see that listed companies are explicitly included in the category of "public interest entities" and we agree that where a country has a law or regulation that defines public interest entities, the auditor should use that definition in applying the Code.

Given that entities of significant public interest may have a large impact on the economy and society in which they function, it does seem reasonable that the audits of such entities should meet a similar standard for auditor independence as listed entities.

While we do not have direct involvement in the application of the Code to entities of significant public interest that are not listed companies, we will pass on our experience in reading the ED. This experience was that understanding what was intended in the Code's discussion of PIEs was not easy. In some cases the coverage seemed to be inconsistent. For example, the definition of "entity of significant public interest" differs between paragraphs 290.22 and 290.23. Paragraph 290.22 provides a useful general principle. Paragraph 290.23 elaborates on the effect of law and regulation, also discusses that IFAC member bodies should determine PIEs if applicable law and regulation do not provide a definition, but then goes on to give examples of entities that would "always" or "normally" or "may" be PIEs. One wonders if it might be more appropriate to make only a principle-oriented distinction between PIEs and non-PIEs.

Q2. Is it appropriate to eliminate the flexibility for small firms to apply alternative safeguards to partner rotation? If such flexibility is appropriate, what alternative safeguards will eliminate the familiarity threat or reduce it to an acceptable level?

Response:

On partner rotation, our members have expressed some mixed views. We all agree on the importance and necessity of addressing familiarity and long time association concerns, but not necessarily on a single best way of achieving this goal. We do not favor a broad and general two-tier standard for audits; however, at the same time, some jurisdictions do make some types of exceptions to the general independence requirements or provide alternative procedures for the very smallest audit firms who are auditing very small listed companies. We expect that these exceptions will continue, and think that some type of exception treatment for carefully defined circumstances is not necessarily undesirable. Please see our comments earlier in this letter regarding the need for the IESBA to consider the subject of rotation on both a short term and a long term basis.

Q3. Is the revised guidance to the provision of non-audit services acceptable?

Response:

We have provided a number of comments on this subject in the main body of our letter. In general, we see some progress in supplying useful guidance but also believe that significant

clarification and further improvement is needed. We encourage the IESBA to consider the findings of the IOSCO Survey on Regulation of Non-audit Services, including portions which reference application of the IFAC Ethics Code, and identify ways to both enhance current guidance and move toward greater global convergence.

Q4. The primary objective of the strengthening of the independence provisions of the Code is to enhance both the perceived and actual objectivity of those performing assurance engagements, thereby enhancing audit quality. Implementation of the new provisions will likely entail some additional costs to stakeholders which are particularly difficult to measure in the context of a global standard. The IESBA is, however, of the view that the benefits of the proposals are proportionate to the costs and therefore the proposals strike the appropriate balance between the differing perspectives of stakeholders. Do you agree?

Response:

We cannot comment on the costs of implementing these proposals, however, as investor confidence in financial reporting is fundamental for efficient and effective capital markets, an appropriate Code on independence and ethics is an essential element in a high quality set of global auditing standards.