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October 15, 2008

Ms. Jan Munro
Senior Technical Manager
International Ethics Standards Board for Accountants
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, NY 10017 USA

Email address: Edcomments@ifac.org

Dear Ms. Munro:

Re: Re-exposed draft of proposed revisions to Section 290 of the Code of Ethics ("Code") for Professional Accountants, "Independence – Audit and Review Engagements".

IOSCO Standing Committee No. 1 on Multinational Disclosure and Accounting ("SC 1") appreciates the opportunity to comment on the proposed revisions to Section 290 of the 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. We have organized our comments that follow largely around the questions asked by the Board in the Explanatory Memorandum that accompanied the Exposure Draft ("ED"), and have included some additional points that we believe warrant the Board's attention.

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Internal Audit Services

Question 1: Internal Audit Services – Respondents are asked for their views on whether the proposed restriction on providing internal audit services to public interest audit clients is appropriate.

We wish to address this question in the categories that follow.

Description of Internal Audit Services

We believe that the Board should provide a more comprehensive discussion concerning activities that typically take place under the label of "internal audit services." The Board should clarify the difference between those internal audit services that create an unacceptable self-review threat and those services that the Board believes would be permitted, specifically,

- Internal audit services which relate to financial reporting (not permitted)
- Internal audit services that relate to the system of controls over financial reporting (not permitted)
- "Other" types of internal audit services (which the Board believes should be permitted, with or without safeguards)

Because the Board has not included a clear and comprehensive description of what activities the Board considers to constitute the kinds of internal audit services that are intended to be prohibited by paragraph 290.200, versus internal audit services that the Board believes should be allowed, it is not possible to conclude whether the proposed restriction is appropriate or not.

We recognize that paragraph 290.195 of the latest draft of the Code has been revised in an effort to better describe examples of internal audit activities. However, the proposed Code does not clearly differentiate internal audit services from other types of non-audit services, and in paragraph 290.201 it uses the term "internal audit" for services to evaluate a specific matter that relates to internal accounting controls and financial reporting matters that the Board describes as "non-recurring". We find this description to be confusing.

There is also a lack of clarity in paragraph 290.195(d) in regard to, "review of compliance with laws and regulations and other external requirements." As many laws and regulations relate to financial reporting and associated internal controls, it is unclear whether this activity meets the conditions described in paragraph 290.200 that "a firm should not provide internal audit services [to an audit client that is a public interest entity] that relate to the internal accounting controls, financial systems, or financial statements", and would therefore be considered a prohibited internal audit service, or whether the Board intends that a review of compliance with such laws and regulations would be considered an activity that would be permitted.

Without further discussion about what is intended to be covered by the internal audit services prohibition for public interest entities, we believe that the Code will likely be applied inconsistently. We request that the Code provide more explicit guidance to help distinguish which types of internal audit services may create an unacceptable self-review threat, as intended by the restriction in paragraph 290.200.

Need to Include Central Principle and Rationale for Treatment of Internal Audit Services

It would be very desirable for the Board to also present a central principle and the rationale involved in explaining its proposed treatment of internal audit services. In this regard, it may be helpful to incorporate some of the discussion that appears in the conceptual framework in the earlier portions of the Code. The articulation of one or more clear principles is desirable as it may not be possible to provide an all-inclusive list of internal audit services, as well the threats and safeguards that the auditor might need to consider in all particular circumstances.

Safeguards Relating to Provision of Internal Audit Services and Communication with Those Charged with Governance

In our letter of December 14, 2007, which was in response to the IESBA's initially proposed exposure draft issued in July 2007, we provided several comments with respect to the safeguards described in paragraph 290.198 (paragraph 290.190 in the July 2007 exposure draft). We continue to think this area needs further development. While we acknowledge that management or those charged with governance (i.e. Boards of Directors and Audit Committees) generally have an oversight role with respect to the work of internal and external auditors; the proposed safeguards in paragraph 290.198 are presented in such a way that they could be interpreted as indirectly attempting, through an auditor ethical standard, to specify requirements for the audit client or those charged with governance, rather than the auditor.

Instead of presenting the auditor's guidance in terms of what management or those charged with governance should do, we believe the focus should be on conditions and actions that are required to be met or performed by the auditor him or herself, including the need to supply the appropriate information to management and those charged with governance.

Rephrasing the safeguards to state something more focused on the auditor's responsibilities would improve the Code's clarity and appropriateness. For example, the Code might state "An auditor shall not perform internal audit services unless the auditor has sufficient evidence that the client and those charged with governance retain appropriate responsibility for the management and oversight of the internal audit work and do not rely upon the auditor to perform management functions. The auditor shall supply appropriate information to management and those charged with governance to enable their understanding of the internal audit work to be performed and the auditor's requirement for independence."

We urge that the Board make this change because in order for the client or those charged with governance to have a basis to understand and approve the scope, risk, and frequency of internal audit work, the client and/or those charged with governance must receive sufficient information from the auditor that is proposing to perform the internal audit services. Management and those charged with governance, including Supervisory Boards and Audit Committees, need factual information that will enable them to sufficiently evaluate the basis for engaging the auditor to provide internal audit services, including descriptions of any threats to independence. The current draft of the Code does not impose any responsibility on the auditor to provide such information to management or those charged with governance and we believe that it should.

Non-Recurring Internal Audit Services Exception

We would like to express a concern regarding the proposed exception in paragraph 290.201 for "non-recurring" internal audit services relating to financial reporting. We believe that writing exceptions to the general principles and prohibitions in the Code seriously weaken the Code and will make it harder to work for convergence and global acceptance of the Code.

We do not understand the need for such an exception and find it confusing and unclear. Unless such services would be "de minimus" 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.

Our members recognize that on occasion auditors and regulators may need to make exceptions for catastrophic situations; however, we have concerns about whether the "non-recurring" internal audit service exception in the ED is adequately defined and it is unclear why such an *internal audit* service would be needed as an urgent service to respond to a natural disaster or other catastrophe. We believe that establishing a requirement or a prohibition and then immediately following it with an exception is contradictory and confusing, and could undermine the prohibition or principle involved. We also have concerns about the way that the non-recurring internal audit service exception in the ED is defined and explained. Further, given that an auditor would not be considered independent for certain recurring internal audit services, it is unclear why the auditor would be considered independent for the same internal audit service simply because it was non-recurring.

As the Code is now written in the ED, it raises the possibility that an auditor could provide any type of internal audit service that creates an unacceptable self-review threat utilizing a rationale, "it is just this one time" and then apply safeguards as necessary to reduce the threat to an acceptable level. We do not consider a blanket "non-recurring exception" an acceptable approach in a Code applicable to audits of a public interest entity.

As one example of our concern, 290.201 includes language stating that "A firm is not, however, precluded from providing to an audit client that is a public interest entity a non-recurring internal audit service to evaluate a specific matter that relates to the internal accounting controls, financial systems, or financial statements provided ..." (several conditions are listed and a reference to application of safeguards as necessary).

Investigating the causes of a one-time significant fraud in an audit client is one example of an internal audit service that would appear to fit into this "non-recurring" exception the Board is proposing. However, we believe such a non-recurring internal audit service could create an unacceptable self-review threat as well as a potential self-interest threat (i.e., conflict of interest) that could not be mitigated with the application of safeguards, if performed by the auditor who has audited the period in which the fraud occurred. We do not understand why this type of service would be described as an internal audit service (as defined in paragraph 290.196) or would be proposed to be permitted.

Finally, we note that the term non-recurring does not have a universally accepted definition, nor do we see it utilized or defined elsewhere in the proposed clarity version of the Code. We believe the use of the term non-recurring in any type of exception in the Code could be inconsistently applied if the Board does not provide additional clarification as to how the term is defined, as well as a rationale for having an entity's auditor perform such a service if this is what is intended.

Question 2: Respondents are asked for their views as to whether there should be an exception for immaterial internal audit services provided to an audit client that is a public interest entity.

We understand that the exception that would permit a firm to provide "immaterial" internal audit services to its public interest entity client would be a broad exception and in addition to the non-recurring exception provided for in paragraph 290.201. As previously noted, we do not support the use

of exceptions to the Code's general principles and stated prohibitions as we believe that stating exceptions in the Code increases the likelihood that the principle underlying the reason for the prohibition will be undermined and compromised.

If the Board ultimately decides to retain some type of exception for immaterial internal audit services relating to financial reporting, we would be concerned about the ability to sufficiently define an "immaterial" internal audit service. Such a definition would need to mitigate the likelihood that exceptions could be applied inconsistently or abused. For example, multiple "immaterial" internal audit service engagements could, in the aggregate, have a significant impact on the financial reporting of the audit client or a more than inconsequential impact on an audit firm's revenues, yet it appears that each could be considered individually to be "immaterial" and presumably, judged by an auditor to be allowed.

We believe an "immaterial" exception should only apply to situations where all amounts involved are de minimus to all parties involved, meaning that they are trivial and inconsequential to both the auditor's revenues or compensation and the client's financial statements. If the Board believes that it is appropriate to retain an exception for immaterial internal audit services, we request that the term be clarified and defined, and that the Code contain some guidance for how the auditor should judge immateriality from all relevant standpoints.

Fee Concentration

Question 3: Respondents are asked for their views on the appropriateness of the required frequency of the application of the safeguard and the requirement to determine whether a pre-issuance review is required in those instances when the total fees significantly exceed 15%

Fees – Relative Size – Paragraph 290.213-.215

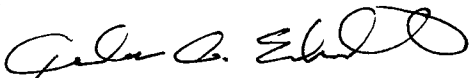
We support the Board's efforts to provide broader and more comprehensive coverage of the threat of self-interest that is created by economic dependence, and to clarify steps to be taken by audit firms, in response to situations where there is economic dependence on specific clients. In our previous comment letter, we noted that the Board had chosen to focus its coverage on economic dependence at the audit firm total revenues level, a situation which generally affects smaller audit firms, but had not adequately addressed the similar economic dependence which can arise with fee dependence of an office or partner, even in a large firm. We note that the latest draft of the Code has provided some coverage on the subject of economic dependence applicable to a partner or office of a firm in paragraph 290.214 and appreciate this added content. However, we do not see any coverage of the partner or office level circumstance in paragraph 290.215, where the Board is proposing to institute a 15% of fees test at a total firm level and to specify certain stipulated remedies.

We believe that a fixed percentage test of relevant revenues and compensation (i.e., partner remuneration) would be more appropriately used as a threshold to create a rebuttable presumption that a self interest threat from economic dependency exists and is significant, whether exceeding this percentage occurs at a firm level or at an office or partner level. This rebuttable presumption would then call for the auditor to institute safeguards that would reduce the risk appropriately, using measures that could be described in the Code or at least provided as examples. If the percentage is exceeded at the total audit firm revenues level, we believe that the audit firm should be required to notify those charged with governance and the pertinent regulatory oversight parties of the measures it has put in place to reduce the threat to an acceptable level.

We recommend the use of the percentage test only as a rebuttable presumption because facts and circumstances are very important in the evaluation of independence issues and in the specification of appropriate remedies, as are the legal and regulatory frameworks involved.

Thank you for the opportunity to comment on this Exposure Draft. If you have any questions or need additional information about the comments in this letter, please do not hesitate to contact me or Susan Koski-Grafer at 202-551-5300 or contact any member of the IOSCO SC 1 Auditing Subcommittee.

Sincerely,



Julie A. Erhardt
Chair
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