November 20, 2008

Ms. Jan Munro
Senior Technical Manager
International Ethics Standards Board for Accountants
International Federation of Accountants
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Email address: Edcomments@ifac.org

Dear Ms. Munro:

Re: Exposure Draft of proposed revisions to the IFAC Code of Ethics ("Code") for Professional Accountants.

IOSCO Standing Committee No. 1 on Multinational Disclosure and Accounting ("SC 1") appreciates the opportunity to comment on the proposed revisions to the Code that have been developed in the International Ethics Standards Board for Accountants ("IESBA") drafting conventions project.

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.

Consistent with the IESBA’s request in the Explanatory Memorandum, we have primarily limited our comments to those proposed changes to the Code that are the result of the drafting conventions project. However, given the increasing focus on international convergence, we have also provided a few comments on the Code which are outside of the drafting conventions but that we think are important enough to call to the attention of the Board at this time. We believe the matters noted will affect the global acceptability of the Code and/or eventual progress.
toward greater convergence, and therefore warrant consideration by the Board now or in projects for future improvements to the Code. We also wish to point out that the added comments of this nature are not intended to be all inclusive – we did not read the Code with a view of whether this would be “an ultimately acceptable Code” but rather have only noted a limited number of items that caught our attention.

We have organized our comments to include general and overarching comments followed by responses to the questions posed in the Explanatory Memorandum that accompanied the ED.

This letter should be read in combination with the recent comment letter submitted to the IESBA regarding the re-exposed draft of proposed revisions to Section 290 of the Code, “Independence – Audit and Review Engagements”. For your convenience we have attached the comment letter as Appendix A, rather than repeat those comments.

**General Comments**

**Use of General and Specific Exceptions**

Making a provision for exceptions to a requirement and writing this into the Code immediately after the requirement is contradictory and undermines the requirements. We do not agree that writing exception language into the Code, as proposed, is an appropriate approach to address exceptional circumstances. We are concerned that the Board's proposed text regarding exceptions will weaken the Code and cause the Code to be applied inconsistently. Further, undermining requirements in the Code with a variety of written exceptions will make it more difficult to make progress toward global convergence in ethics and independence requirements. As such, we do not believe the Code should include an exception for inadvertent violations or exceptions for exceptional and unforeseen circumstances. However, if the Board ultimately decides to retain these exceptions in the current version of the Code to be issued, we have provided specific comments below.

**Exception for inadvertent violations**

The Code has provided an exception for “inadvertent” violations of the requirements, stating that such violations are not deemed, or shall not be deemed, to compromise independence provided certain conditions are met and adequate safeguards are applied. We believe that writing an exception for inadvertent violations which implies that all such violations can be corrected through application of “any necessary safeguards”, may encourage unscrupulous behavior and potential abuse of compliance with the Code and should be removed.

Paragraph 290.117 (a) states, in part “[T]he firm has established policies and procedures that require prompt notification to the firm of any breaches from the purchase...of a financial interest in an audit client.” Given that a “purchase” of a financial interest is a conscious action, it does not seem appropriate to characterize this action as “inadvertent”, especially given a firm should have adequate policies and procedures in place to avoid this type of situation. The example highlights the potential for abuse in deeming any violation as “inadvertent” and simply applying remediation procedures subsequent to the violation.

A broad exception for inadvertent violations could detract from motivating Firms to establish robust preventative controls to properly identify threats to independence prior to providing prohibited services. If an exception for inadvertent violations is retained in the Code we urge the Board to include a sufficiently narrow and prescriptive definition of the term “inadvertent” as well as include a materiality threshold for evaluating when an inadvertent violation could and could not be deemed to compromise independence.

**Exception for exceptional and unforeseen circumstances**

Paragraph 100.11 states, in part

In exceptional and unforeseen circumstances that are outside the control of the professional accountant, the firm or employing organization, and the client, the application of a specific requirement in the Code may result in an outcome that a reasonable and informed third party would not regard as being in the
interest of the users of the output of the professional services. In such circumstances, the professional accountant may judge it necessary to depart temporarily from that specific requirement. Such a departure would be acceptable only if all of the following conditions are met... [four conditions follow].

As the Code is now written, it appears to allow a professional accountant to "override" any requirement under the guise that the matter is outside the professional accountant, the firm, and the client’s control. In this situation the professional accountant is only required to discuss and document the matter with those charged with governance, disclose the matter to users of the output of the professional services and comply with the requirements of the Code at the earliest date that such compliance can be achieved. The latter point is highly subjective. Further, the requirement for a professional accountant to appropriately disclose "the nature of the departure and the reasons for the departure" to the users of the output of the professional services is vague and therefore could be interpreted and implemented inconsistently. In the case of publicly listed companies, the users of the auditor’s output – the auditor’s report and opinion – could be widespread. Is the Code proposing that the auditor would include reference to this exceptional circumstance in the audit opinion? The four conditions do not appear to be adequate safeguards that would reduce threats to an acceptable level in all circumstances. Additionally, we are uncomfortable with the broad language in this exception and the implication that at times non-compliance with the Code’s requirements would be necessary. It can be argued that many circumstances are “exceptional and unforeseen”, and/or that certain events or matters are outside of the control of the professional accountant, the firm, and the client. In addition, the Code does not provide a definition for "exceptional", leaving open the possibility to argue that "exceptional" is anything other than "the usual". For example, does an “exceptional” item have to be highly unusual and rare, or just not what happens most typically and frequently? This creates an ambiguity that weakens the Code.

We acknowledge that the Explanatory Memorandum states:

A departure is only acceptable if the circumstances are exceptional and unforeseen and are outside the control of the professional accountant, firm or employing organization, and the client. A departure cannot occur if compliance is possible but would be inconvenient to the professional accountant, firm, employing organization or client.

However, the partner rotation example provided in the Explanatory Memorandum appears to be an allowable temporary departure that is “inconvenient” to the firm and not fully “outside the control” of the firm as the violation could have been prevented with proper planning. For example, in a firm that has an extremely limited number of partners to serve public interest entities in specialized industries, partner rotation could occur more frequently than is required by the Code to avoid being caught in a situation where time has run out. Special efforts could also be made to increase the number of partners with experience in an industry, and/or to develop contingency plans should one or more partners become unavailable. Although this might be inconvenient for the professional accountant, the firm, and the client, one can argue that the departure could have been prevented with such advanced planning.

Our members recognize that on rare occasions natural disasters or other catastrophic situations call for a suspension of usual requirements or for the granting of allowances or regulatory relief for actions that are violations of normal practices. However, the exception as written in the Code is too broad, and the four conditional requirements that are provided do not appear to be adequate safeguards. If the Board wishes to make some reference to exceptions associated with catastrophic situations that are regulator-approved departures from requirements, it should do so with specific exceptions for specific circumstances using much narrower and more precise language.

Exception to a prohibition

Paragraph 290.174 includes an exception for providing accounting and bookkeeping services, which would not otherwise be permitted, “in emergency or other unusual situations where it is impractical for the audit client to make other arrangements”. This appears to be mixing two very different kinds of conditions. We believe that “emergency situations” would be widely understandable around the world as natural or man-made catastrophes, ranging from catastrophic disasters to lesser but still problematical emergencies such as major system crashes and
the like. But the phrase "or other unusual situations when it is impractical to make other arrangements" is very broad and could be interpreted and applied inconsistently on a global basis (or even within a country.) We believe that the exception for "other unusual situations" should be removed. If the IESBA chooses to keep the exception in the Code, we request that the Board clarifies what is intended to be covered by this condition. Further, the term "impractical" is not defined in the Code. As the term is vague, there could be inconsistent interpretation and application or potential abuse. For example, multinational audit clients not infrequently have small offices or joint venture operations in remote locations that are far removed from the company’s main operations. If it is the intent of the IESBA to allow the auditor to provide accounting and bookkeeping services for such locations, because it is "impractical" for management to arrange otherwise, the IESBA should address this explicitly in the Code and include the rationale and safeguards that the Board considers to be appropriate (i.e., is impractical intended to mean not possible, or just not cost effective?). That way, auditors, issuers and regulators would have a clear and consistent understanding of what is intended. The current text used in the Code is ambiguous.

We reiterate our 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. Please refer to Appendix A for additional detail and comments related to Section 290 of the Code.

In summary, although we agree that there may be circumstances that require departure from the Code, we do not believe the various exceptions currently included in the Code are appropriate. To address this, we recommend the Code include a provision that would require professional accountants to follow the procedures detailed in proposed International Standard on Quality Control when there is a violation.

Clarity of the Code – Deviation from the IAASB International Standards on Auditing ("ISAs") Clarity Format

Some of our members are not convinced that the Board has presented a clear and comprehensive rationale, in the Explanatory Memorandum that accompanied the Exposure Draft, for its decision not to utilize a format more similar to that used for ISAs (i.e. presenting the objective to be achieved, the requirements designed to achieve that objective, and the application material). For example, it can be argued just as easily for ISAs that the standards are all supporting a single overriding objective.

Notwithstanding this comment, we observe that rewriting ISAs into the clarity format used for those standards took several years, and it is unclear how much of the time was due to reformatting the standards and how much was due to questions that arose when the language was changed to introduce “shall” for intended requirements. We do not believe it would be desirable to significantly delay making some incremental clarifications and improvements in the Code on a timelier basis in the current project to improve the clarity of the code. As a suggestion, we encourage the IESBA to prepare a “trial” section of the Code in the ISA Clarity Format to assess whether this format would be more beneficial in improving clarity and whether it really would require a substantial amount of additional time to recast the Code in this way. We note that each of the fundamental principles could be presented as an objective to be attained. Some members believe that organizing the content in the Code in this way might further clarify the Code and promote more consistent application.

If this recasting effort cannot be accomplished in the current drafting conventions project, perhaps this could be studied and evaluated by the Board in a future improvement effort.

Documentation and Evaluation of Threats Identified that are Below an Acceptable Level

With the removal of the term "clearly insignificant", the code does not appear to provide sufficient guidance as to either documentation or evaluation procedures for threats that are greater than inconsequential but not above an acceptable level. The Code appears to have a documentation gap between threats that are initially identified as above an acceptable level (documentation required) and those that are at or below an acceptable level (no documentation required).
We agree that there must be documentation of the auditor's actions to identify, evaluate, and respond to threats to independence and objectivity. However, the Code does not require documentation of the process of identification and analysis of threats that are judged by the professional accountant to be at or below an acceptable level, rather it only requires documentation of cases where a threat is initially judged greater than acceptable, and is then reduced to an acceptable level through the application of safeguards. We are concerned that the Code does not have adequate guidance that would require the professional accountant to identify, specifically evaluate, and document all possible threats to independence, including those that are ultimately determined to be at an acceptable level.

To address the documentation gap, the concept of clearly insignificant should be included and defined in the Code. Documentation of all threats identified that are above clearly insignificant should be required, including the professional accountant’s assessment and conclusion regarding why these threats are at or below an acceptable level. We do support that there should be no requirement to document threats that are clearly insignificant. We believe that documentation is an important driver of attention and behavior and requires the professional accountant to give due consideration to the identification and assessment of all threats identified that are above clearly insignificant, rather than a default conclusion that all threats are acceptable without a robust evaluation of the facts and circumstances. Further, documentation of threats identified that are above clearly insignificant but at or below an acceptable level allows the professional accountant to determine if the threats identified are at or below an acceptable level on a cumulative basis.

**Inconsistent Use of Shall**

We agree that the use of the world "shall" to communicate a requirement is clearer and more direct than the variety of ways that the Code previously covered such matters. However, we note that the Board has not applied the new use of "shall" consistently where requirements exist.

In order for the use of "shall" to clearly denote requirements, we believe it must be applied consistently. We believe it weakens the clarity of the Code to continue to use various other terms and phrases to also indicate requirements. As one example we cite paragraphs 100.6 and 290.7, in which phrases are used such as "...this Code provides a conceptual framework that requires a professional accountant to identify, evaluate, and address threats to compliance with fundamental principles" and "A conceptual framework approach to achieving and maintaining independence involves using professional judgment to apply the framework. The framework requires the professional accountant to (a) Identify threats to independence; (b) Evaluate the significance of the threats identified; and (c) Apply safeguards when necessary to reduce threats to an acceptable level..."

Nowhere in the Code do we find a clear and unequivocal requirement for the professional accountant to identify threats stated in the clarified language such as, "The professional accountant shall identify threats to independence."

We would expect a suitable and rigorous Code to explicitly require the auditor to actively assess (and thus perform some procedures) whether threats exist. The wording of, amongst others, paragraph 100.7 states

...when the professional accountant identifies threats to compliance with the fundamental principles that are not at an acceptable level, the professional accountant shall determine whether appropriate safeguards are available...

The language used in the Code seems to suggest to some of our members that the auditor may sit back without seeking any information or performing any procedures to be able to assess whether a threat exists, if the auditor has a view at the outset that no unacceptable threats are present. If this were true, we would not consider this an acceptable Code.

**Definition of Safeguards**

We note that the Code does not define the term safeguard. Given the Code relies on a “threats and safeguards” approach to assessing independence; we believe that this term must be sufficiently defined in the Code. While
the definition may seem obvious to some, in an international environment a common understanding can not be assumed. For example, is a safeguard anything that reduces risk, whether general or specific? Or does it only include actions taken that are specific to the risks identified on individual engagements?

We believe the Code does not adequately distinguish between a safeguard that specifically mitigates an identified threat and "safeguards" that are equivalent to general quality control or best practices. For example, paragraph 100.15 states that safeguards created by the profession, legislation or regulation include general, enabling safeguards (such as education, training and experience requirements), standards and regulations, and professional and regulatory monitoring and external review by a third party. Although we agree that all of these contribute to good audit practice, we think that the Code should mention more explicitly that general environmental safeguards do not mitigate specific threats in an engagement, including that the auditor, upon identifying a threat, shall apply engagement specific safeguards to mitigate such threat rather than relying on the general safeguards created by the profession, legislation or regulations.

In addition, we do not agree with certain examples of safeguards that are provided in the Code. For example, paragraph 200.13 provides examples of engagement-specific safeguards in the work environment. Two safeguard examples appear to involve using other professional accountants in a particular firm (who were not part of the team providing the services) to review the work performed by the engagement team. The first states, "Having a professional accountant who was not involved with the previous non-assurance service review the non-assurance work performed or otherwise advise as necessary." The second states, "Having a professional accountant who was not a member of the assurance team review the assurance work performed or otherwise advise as necessary." Some of our members would question whether this is an adequate safeguard given the self-interest and self-review threat that also exists on a firm-wide basis. For example, if the firm has provided a non-audit service that will be subject to audit, the firm is not independent, and so the two actions just described would not constitute suitable safeguards for an audit engagement in those jurisdictions. We have some concern that the language in this paragraph might be misinterpreted and lead the professional accountant to conclude that a self-interest and self-review threat only applies to the individuals on an engagement team, rather than to the entire firm itself.

Another example of an inadequate safeguard is included in Paragraph 210.3. The safeguard example is to secure "the client's commitment to improve corporate governance and internal controls." Although we agree this is a best practice or a good quality control, we do not believe that a promise by management and/or those charged with governance to make changes in the future is a sufficient tangible action to use as a safeguard to mitigate an identified threat.

Responses to the Questions Posed in the Explanatory Memorandum that Accompanied the Exposure Draft

Question 1. The IESBA is of the view that identifying a requirement by the use of the word shall clarifies the Code and appropriately brings the language in line with that adopted by the IAASB. Do you agree?

We agree that the use of the world "shall" to communicate a requirement is clearer and more direct than the variety of ways the Code previously covered such matters. This helpfully brings the language in line with that adopted by the IAASB. However, we note that the Board has not applied these terms consistently. Refer to Inconsistent Use of Shall section above for further comments.

In addition, we have included two illustrative paragraphs that we believe do not apply the “shall” convention correctly.

Paragraph 220.3 states, "Depending upon the circumstances giving rise to the conflict, application of one of the following safeguards is generally necessary." We believe this sentence should state, "Depending upon the circumstances giving rise to the conflict, the professional accountant shall apply one or more of the following safeguards."

Paragraph 290.7 discusses the conceptual framework of identifying threats to independence, evaluating the threats, and applying safeguards if threats are not at an acceptable level. Paragraph 290.7 (c) states, "Apply
safeguards when necessary to eliminate the threats or reduce them to an acceptable level." We believe this sentence should state, "If threats exist that are not at an acceptable level, the professional accountant shall apply safeguards to eliminate the threats or reduce them to an acceptable level."

**Question 2**. The IESBA is of the 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. Do you agree?

Refer to comments above.

**Question 3**. The IESBA is of the view that in exceptional and unforeseen circumstances that are outside the control of the professional accountant, the firm or employing organization, and the client, the application of a specific requirement in the Code may result in an outcome that a reasonable and informed third party would not regard as being in the interest of the users of the output of the accountant’s professional services. Therefore, the Board is proposing that the Code include a provision that would permit a professional accountant, in such circumstances, to depart temporarily from that specific requirement. This would not be the same as provisions in the Code that address situations in which a professional accountant has inadvertently violated a provision of the Code. The departure would only be acceptable if all of the conditions set out in paragraph 100.11 are met.

(a) Do you agree that the Code should contain a provision that permits any exception to compliance with a requirement set out in the Code? If you do not agree, please provide an explanation.

(b) If you believe that the Code should contain a provision that permits an exception to compliance, are the conditions under which the exception would apply appropriate? Should there be additional or fewer conditions and, if so, what are they?

(c) If you believe that the Code should not contain a provision that permits an exception, please explain how you would deal with the types of exceptional and unforeseen situations that may be covered by paragraph 100.11.

(d) Are there any other circumstances where you believe a departure from a requirement in the Code would be acceptable? For example, should an event that is within the control of one of the relevant parties qualify for an exception? If so, please provide an explanation and specific examples of the circumstances where you believe a departure would be acceptable.

Refer to Use of General and Specific Exceptions section above.

**Question 4**. The IESBA is of the view that the proposed modification to focus the application of the conceptual framework throughout the Code, and the related documentation requirements in Sections 290 and 291, on threats that are not at an acceptable level, will result in a more efficient and effective application of the framework approach. Do you agree?

We are not sure we fully understand all that this question is intended to be referring to, but we can offer the following comments. We agree it is desirable to refer to and reinforce the principles in the conceptual framework approach throughout the Code. See comments above regarding documentation requirements for threats that are at or below an acceptable level.

**Question 5**. The IESBA is of the view that the selected point-in-time effective date with the proposed transitional provisions will provide the appropriate balance between firms and member bodies having sufficient time to implement the new standards and effecting change as soon as possible. Do you agree?

We do not object to the IESBA setting whatever effective dates it believes are needed to allow for adequate preparation and implementation. However, we observe that there are several proposed effective dates for different sections and provisions in the proposed Code. To an external reader, this appears rather complex and it
was not clear how an audit firm would actually implement different portions of the new Code at interim points in a client's reporting year, and what the firm would be required to say or disclose as a result. We request that the Board clarify the effective dates and transitional periods, including the procedures involved and the supporting rationale, in the final standard.

Thank you for the opportunity to comment on this Exposure Draft. We recognize that some of our comments address issues and concerns that may be broader than the editing changes the Board has made to clarify the Code in its present form, i.e., the form that exists following the improvements the Board has deliberated on in the current Code improvement project. We understand that some of the comments may not be actionable until a future Code improvement project, perhaps one that could focus both on improvement and global convergence. We believe it is most helpful to make the Board aware of some of these questions and concerns at this time, so that as many areas can be addressed as possible in the first edition of a clarified Code.

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,

[Signature]

Julie A. Erhardt
Chair
IOSCO Standing Committee No. 1
October 15, 2008

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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 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 (“special investigations”) that relate to internal accounting controls and financial reporting matters that the Board describes as “non-recurring”. We find this description of special investigations as internal audit services 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 services that create 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 a 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.

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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,

[Signature]

Julie A. Erhardt
Chair
IOSCO Standing Committee No. 1