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accrédités

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

Email: Edcomments@ifac.org

Re: Exposure Draft, December 2006, Independence – Audit and Review Engagements, (Section 290 of the Code of Ethics), and Independence – Other Assurance Engagements, (Section 291 of the Code of Ethics)

Dear Sir/Madam:

The Certified General Accountants Association of Canada (CGA-Canada) welcomes the opportunity to comment on the Exposure Draft, approved December 2006, titled Independence – Audit and Review Engagements, (Section 290 of the Code of Ethics), and Independence – Other Assurance Engagements, (Section 291 of the Code of Ethics). Our comments respond to the questions set out in your *request for specific comments*. Additional comments by us follow these responses.

CGA-Canada supports a strong international Code of Ethics which is universally applied. Such a code, especially if it is publicized widely and applied firmly and fairly on a global basis, can be a strong positive factor toward the building of strong economies, in all regions. A rigorous code is critical to building trust and respect for the profession. To this end, regular review of the code is necessary and important and we support this work.

1. 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?

Comment: CGA-Canada agrees that the provisions for listed entities should be extended to “entities of significant public interest.” It seems apparent to us that regulated financial institutions, certain private businesses, government agencies, and controlled entities and *certain* not-for-profit organizations affect significant numbers of stakeholders by virtue of their economic or social impact on significant stakeholder groups. Those that do should be included in the category of entities of significant public interest. We concur, in the interests of simplicity, efficiency, and equitability that, generally speaking, all of the listed entity provisions should be applied to all entities of significant public interest – not just listed companies.

In our view, it is appropriate that, depending on the facts and circumstances, regulated financial institutions would normally be entities of significant public interest. We also agree that pension funds, government agencies, government-owned entities, and not-for-profit entities **may** be entities of significant public interest.

However, it cannot be emphasized enough that there is a wide variation within these categories. Pension funds may include as few as one person and as many as several hundred thousand. Not-for-profit organizations may have fiduciary responsibilities affecting a significant part of the population (e.g., a national charity organization) or virtually no such responsibilities and only a small number of stakeholders (e.g., a group of parents organizing a children’s neighborhood sporting league.) Government-owned entities may be as small as a village football field or as large as a major national electrical power utility.

Proportions **must** be guarded here, especially in light of the proposed changes regarding partner rotation (290.147), bookkeeping services (290.166), tax calculations (290.173), and material valuations (290.178) to be applied to entities of significant public entities. Large numbers of smaller agencies, not-for-profit organizations, and the like simply do not have in-house resources to perform calculations of deferred tax assets and liabilities, prepare all the year-end adjustments and disclosures to comply with IFRS, or perform material valuations. It is not reasonable in many cases that they should engage several firms to perform these functions; the inefficiencies should be apparent. Moreover, smaller audit firms who may not be able to meet the rotation requirements set out in the ED, may, in fact, be better suited to serve such smaller entities by virtue of their flatter organizational structure, experience, and expertise in providing assurance services to them. Safeguards such as those suggested by way of example at 290.165 for bookkeeping, 290.170 for valuations, and 290.177 for taxation services should be sufficient for such smaller entities.

The matter comes down to the meaning of “significant public interest.” We recommend further guidance be provided regarding the interpretation of “significant” in this context. Perhaps “significance” for this purpose should be understood to mean national or regional economic or social impact. **Further, it should be made very clear that there is no intention to include all pension funds, government agencies, or not-for-profit organizations in the category of entities with significant public interest.**

2. 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?

Comment: Although CGA-Canada is sympathetic to the removal of the flexibility for small firms to apply alternative safeguards to partner rotation in the case of entities of significant public interest, we are concerned with longer-run implications.

It is definitely not in the public interest that smaller firms be restricted to the point that they are not economically viable and cannot develop as competitors for larger firms. Many larger firms are turning away smaller audit clients as it is not worth the firm’s investment to maintain the accounts. This certainly cannot be in the public’s best interest and efforts must be made to maintain this area of practice, especially for those SMPs who have an interest in servicing them. Further, there is no doubt in our minds that smaller audit clients would agree with us on a cost-benefit basis.

We believe that a specific safeguard requiring the use of a quality control reviewer independent of both the client and the audit firm would, in our view, reduce the familiarity threat to an acceptable level. However, it should be emphasized that in the absence of another acceptable alternative for the SMP, this should, at a minimum, be the permissible course of action. It should be noted that it is our view that it is unlikely that the increased cost associated with such a safeguard would exceed the benefit gained by the safeguard.

There is a concern expressed in the ED in the Explanatory Memorandum under *Association of Senior Personnel (Including Partner Rotation)* "...that if there was insufficient depth within the firm to rotate the required partners audit quality might be affected." However, existing assurance standards require in all cases that firms not accept engagements for which they do not have adequate knowledge or resources and this standard is normally enforceable by disciplinary procedures if violated.

If, after considering comments on the ED, IESBA decides to proceed with the removal of flexibility for smaller firms, we recommend that this change be taken into account regarding guidance on where the line should be drawn with respect to entities with and without significant public interest.

We agree with the continuation of the seven years on and two years off rule when partner rotation applies.

3. Is the revised guidance related to the provision of non-audit services appropriate?

Comment: CGA-Canada concurs with the requirements set out at 290.165 and 290.166 regarding the preparation of accounting records and financial statements. We emphasize again that these sections need to be considered in additional guidance regarding the line between entities with significant public interest and other entities. Entities that do not have the resources for full-time accounting staff sufficient to maintain accounting records or draft financial statements in accordance with IFRS would almost certainly **not** qualify as having "significant public interest."

Virtually the same point can be made regarding entities which do not have resources or sufficient requirement to employ in-house staff capable of calculating deferred tax liabilities or assets, 290.177–290.178, or performing valuations for financial statement purposes, 290.169–290.173.

With regard to taxation services, CGA-Canada concurs with the ED on tax planning and other advisory services as set out at 290.170–290.182, and on assistance in resolution of tax disputes, 290.183–290.185.

4. 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?

Comment: We at CGA-Canada are unsure on what basis the IESBA has formed its view that benefits of the proposals are proportionate to the costs (i.e., have studies been conducted which quantify and support this assertion?). We are also not clear what "proportionate to the costs"

means. To be clear, we believe that, in almost all cases, the benefits should be **equal to or exceed** the costs.

Anecdotal information indicates, that, in Canada at least, as a result of the substantial changes in auditing standards, including new independence rules that apply to such engagements, the fees for typical annual audits of general purpose financial statements have risen by 15% to 40% over the past two years. CGA-Canada agrees that global events, from the increasing sophistication of global financial markets and financial instruments, to the massive corporate scandals over the past several years, have required clearer and better accounting and auditing standards and stronger ethical rules.

Nevertheless, small and medium entities correctly ask where the benefit may be found for them and their financial statement users. SMEs largely do not participate, except perhaps neither peripherally in global financial markets, nor do they use the range of sophisticated financial instruments that public companies often use.

It is our view that the international accounting profession has not responded adequately to this question. Where are the models of cost and benefit regarding accounting and auditing standards and ethics rule changes? Surely a profession that exists in large measure to quantify financial benefits and costs is capable of developing such models. How can we excuse ourselves on the basis that development of such models may be difficult while imposing ever more difficult rules on SMEs and their auditors?

In the interim, at the level of the individual small and medium entity, there is little doubt that including them by over zealous or careless application of the concept of “entities with significant public interest” would significantly increase cost with little or no demonstrable benefit that we can see, and little or no outcry that we are aware of from users of the financial statements of such entities over how the independence of the auditors of such entities is currently governed.

Special Considerations on Application in Audit of Small Entities
Respondents are asked to comment on whether, in their opinion, considerations regarding the audit of small entities have been dealt with appropriately in the proposed revisions to the Code. Reasons should be provided if not in agreement, as well as suggestions for alternative or additional guidance.

Comment: IESBA should ensure, by increased and clearer guidance materials on the application of the concept of “entities with significant public interest,” that SMEs and smaller not-for-profit organizations are not included in the category “entities of significant public interest.”

Additional Comments

CGA-Canada concurs with the proposed changes regarding “Restricted Use” non- financial statement audits.

CGA-Canada concurs with the proposed change to the definition of the engagement team.

CGA-Canada concurs with the proposed addition of “key audit partner” as a defined term and with the proposed definition.

CGA-Canada is concerned that sections 290 and 291 are evolving towards a very rules- based approach. As section 290.8 now states:

“Many different circumstances, or combination of circumstances, may be relevant in assessing independence. Accordingly, it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action. A conceptual framework that requires firms and members of audit teams to identify, evaluate and address threats to independence rather than merely comply with a set of specific rules that may be arbitrary is, therefore, in the public interest.”

In our view this approach remains correct. However, the clear direction of the proposed amendments is a movement from the intended conceptual approach and in our view takes a prescriptive rules-based approach. This is not in the public interest.

In our estimation, the additional constraints proposed on the provision of tax services to clients ignores jurisdictions which presently permit both assurance and tax services to be provided to the same client. While CGA-Canada appreciates that these services are already separated in certain countries, for those countries where this regime is not employed it has severe consequences, and inconvenience to the client that would benefit from both services being provided by the same firm (i.e., cost benefit). Any independence concerns could be mitigated through the use of external review provisions.

Proposed section 290.197, under the area of IT systems, prohibits both the design and/or implementation of systems that form a significant part of the accounting systems, or generate information that is significant to the client’s financial statements on which the firm will express an opinion for entities with significant public interest. In our view, this seems to carry the prohibition too far. We are not convinced that the simple implementation of a new software system requires prohibition and believe that this may be better dealt with by safeguards. Perhaps this is not the intent, and additional guidance would suffice.

Under loans and guarantees, section 290.117, the second last line, reference is made to a network firm that is not involved in the audit. Why does this reference a network firm? Could it not be any professional colleague?

Under financial interests, section 290.110 appears to have little hope of concrete enforcement. According to the ED, “...when the immediate family member has or obtains the right to dispose of the financial interest or, in the case of a stock option, the right to exercise the option, the financial interest should be disposed of or forfeited as soon as practicable. “Practicable” does not include selling at a loss if it can be avoided by holding the asset to some other date. In our view, ethical rules requiring those not involved in the profession to take action are ‘ultra vires’. All we can hope to do is govern our own behaviour.

Under employment with assurance clients, section 291.127, there appears to be an error. It reads:

“In all cases the following safeguard is necessary to ensure that no significant connection remains between the firm and the individual does not continue to participate in the firm’s business or professional activities:

The underlined portion seems to be an error. Please see the wording used in 290.132.

In addition, these parallel sections (290.132 and 291.127) are differentiated with respect to the safeguards suggested with regard to “remaining threats” near the end of each section. The first two suggested safeguards in 291.127 do not appear in 290.132. We see no clear reason why these

should be inconsistent. In our view, the first is excessively detailed and should be removed from 291.127, and the second (which we believe subsumes the first suggested safeguard) should be added to 290.132.

Under recent service with an audit/assurance client, the following draft sections appear:

290.139 Self-interest, self-review or familiarity threats may be created if a former director, officer or employee of the audit client serves as a member of the audit team. This would be particularly the case when, for example, a member of the audit team has to evaluate elements of the financial statements for which he or she had prepared the accounting records while with the client.

291.130 Self-interest, familiarity or intimidation threats may be created if a former director, officer or employee of the assurance client serves as a member of the assurance team. This would be particularly true when, for example, a member of the assurance team has to evaluate elements of the subject matter information he or she had prepared while with the assurance client

In the interests of clarity and simplicity, CGA-Canada holds the view that these paragraphs should be identical except that 290.139 refers to audits and 291.130 refers to assurance engagements. IESBA should clarify why the listed threats are different. We do not see why a difference might exist.

In conclusion, CGA-Canada looks forward to the results of the comment period and IESBA's response.

Should you wish to discuss or require elaboration on any of the items presented above, please do not hesitate to contact Dawn McGeachy (dmcgeachy@cga-canada.org) or the undersigned at rlefevre@cga-canada.org.

Sincerely,
[Original signed by:]

Rock Lefebvre, MBA, FCIS, CGA
Vice-President, Research & Standards