



## BACKGROUND INFORMATION - Rule 204 – Auditor Independence

Council endorsed the proposal to amend Rule and CI 204 regarding auditor independence after an extensive national consultation process. The process commenced in June 2001 with a forum of representatives from the profession (from both inside and outside of public practice), securities regulators, academics and others. It also included the release of an Exposure Draft of the proposed changes last September by CICA's Public Interest and Integrity Committee (PIIC).

Prior to the Exposure Draft being released, the preliminary report of the PIIC had been circulated to the Provincial Institutes for comment and reaction in May 2002. In Manitoba we established a Task Force that provided recommendations to Council on its response to the first draft. The Task Force had some suggestions for improvement but was generally supportive. Revisions to the May 2002 recommendations were further reviewed by the Task Force in July 2002. Again the Task Force was generally supportive. The Exposure Draft was then issued in September 2002.

The responses to the Exposure Draft were mixed. While there was general support across the country for much of the document, there was also some push back from some small and medium-sized firms.

Concerns seemed to focus on two issues. The first related to a lack of clarity about the level of proposed standards that were intended to apply to practitioners performing review engagements. Many of the smaller firm practitioners believed that the proposals as drafted might "put them out of business". The second concern was whether or not firms auditing smaller public companies should have to meet the same requirements of those auditing larger public companies.

During the early part of 2003, the PIIC reviewed the comments arising from the Exposure Draft, while at the same time monitoring developments in the US with the Securities Exchange Commission and the Sarbanes-Oxley Act. Based on the Exposure Draft feedback and developments in the US, the PIIC released a confidential discussion document in May 2003 for review and comment by interested stakeholders. ICAM's Task Force reviewed this document and reported its general support to Council, which then advised PIIC of its support.

The May 2003 confidential consultation draft addressed many of the concerns that had been raised during the exposure period, including provisions to clarify the application of the proposals to small- and medium-sized practices and setting a \$10 million threshold to differentiate the rules related to assurance services provided to publicly traded companies.

The PIIC then issued the final document this September, together with background information and a guide to provide members with additional resources to review and understand the material. The guide is included with this package and is also available on the website at [www.icam.mb.ca](http://www.icam.mb.ca) together with the full text of the proposed amendments to Rule 204 and other explanatory material.

## BACKGROUND INFORMATION - Rule 206 – Compliance with Professional Standards

At approximately the same time, the profession was subject to a good deal of scrutiny by the securities regulators in Canada, which had expressed some concern about a decrease in the quality of financial reporting of publicly-traded companies. One of the concerns that the regulators raised related to the application of what has become known as “fringe GAAP” or “extreme interpretations” of GAAP. The focus of the concern centred on situations where the exercise of professional judgment was being used to excuse applications and interpretations of GAAP that a majority of practitioners would consider to be inappropriate or misleading. Put another way, there was concern that extreme interpretations or accounting policies on the “fringe” of GAAP were being used to manipulate results when a fairer, more usual interpretation or policy could and should have been adopted. As a result of these concerns, the Ethics Standards Harmonization Committee (ESHC) was asked to draft revisions to Rule 206, which addresses members’ compliance with professional standards.

Amendments to Rule 206 were another of the many ways in which the profession could address the regulators’ concerns and work with them towards restoring investor confidence in the markets. Accordingly, revisions were proposed that would expand the existing Rule 206, which requires members in public practice to comply with professional standards (including the CICA Handbook), to encompass **all** members.

Of course, all members are currently governed by Rule 205 as well, which prohibits any member from association with false or misleading statements. Accordingly, the situation where a CA is the CFO or Controller for a business that issues misleading statements has always been addressed by Rule 205.

There was a belief, however, that a specific provision regarding **all** members’ responsibility to comply with professional standards was required, particularly in light of the regulators’ concerns. Accordingly, the new proposals require that all members, whether acting as assurance providers, preparers of financial statements or as members of boards with oversight responsibility for financial statements, must comply with professional standards.

The CI to the rule provides guidance as to the steps that a member might be expected to take when a possible breach of standards occurs, effectively stating that a member should raise the concern with those who are responsible and escalate the concern to highest possible level if the concern remains unaddressed.

The CI also establishes the level of expertise that a board member may reasonably be expected to bring to his or her role on the board. That level of expertise is the knowledge and skills of a “competent CA”. Such a competent CA, as defined in this context, is not required to be an expert in financial accounting and reporting matters nor to act as professional advisor to the board. A competent CA is required to be generally aware of issues, and to raise and engage in discussion of those issues.

In considering the proposed amendments to Rule 206 consultations were held with members in industry, securities regulators and other members. Several drafts were reviewed by ICAM’s Bylaws Advisory Committee and Council and fairly extensive changes were made by ESHC based on feedback from these reviews.

Final proposed amendments were issued by ESHC in September and, as indicated earlier, Council has unanimously endorsed those amendments for consideration by the general membership at the Special General Meeting on November 27.