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IMF POLICY PAPER

PROPOSED MODIFICATION OF THE POLICY ON PROVISION OF CONSULTING SERVICES BY THE EXTERNAL AUDIT FIRM

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- The **Staff Report** on Proposed Modification of the Policy on Provision of Consulting Services by the External Audit Firm was prepared by IMF staff and completed on May 8, 2014 for the Executive Board's consideration on May 28, 2014.
- The **Staff Supplement** on Proposed Modification of the Policy on Provision of Consulting Services by the External Audit Firm—Revised Proposed Decision.

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International Monetary Fund
Washington, D.C.



PROPOSED MODIFICATION OF THE POLICY ON PROVISION OF CONSULTING SERVICES BY THE EXTERNAL AUDIT FIRM

May 8, 2014

EXECUTIVE SUMMARY

At an informal Board meeting in January, there was broad support for removing the current blanket prohibition on the provision of non-audit-related consulting services by the Fund's external audit firm and replacing it with a blacklist approach, subject to robust safeguards to ensure the independence of the external audit firm.

This paper makes specific proposals to implement such a change. This would align the Fund's policy on the provision of consulting services by the external audit firm with practices followed in major jurisdictions and allow the external auditor to perform certain consulting services with proper safeguards to maintain the auditor's independence. The proposed safeguards include: (i) a blacklist of prohibited services; (ii) an independence declaration by the external audit firm; (iii) limitations on the consulting fees that can be paid to the external audit firm; (iv) an oversight role for the External Audit Committee (EAC); and (v) review of consulting services provided by audit firms prior to the selection of a new external audit firm for the Fund.

The staff sought the views of the EAC, which concurs with the proposal to modify the policy on the provision of consulting services by the external audit firm along with the related safeguards.

Approved By
Andrew Tweedie (FIN)

Prepared by the Finance Department in Consultation with the Legal
Department and other Departments

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INTRODUCTION

1. **In January 2014, the Executive Board held an informal discussion on aspects of the Fund’s external audit arrangements.** These included (i) whether to proceed with the upcoming mandatory rotation of the external audit firm; (ii) whether to move away from the current blanket prohibition on the provision of non-audit-related consulting services to a blacklist of consulting services with additional safeguards and oversight; and (iii) possible steps to further enhance the effectiveness of the External Audit Committee (EAC).

2. **There was broad agreement that the Fund should replace the blanket prohibition on non-audit-related consulting services with a blacklist of prohibited services, combined with robust safeguards to maintain the independence of the external audit firm, if non-blacklisted services are contracted.**¹ This approach would be more in line with current practices of many public and private sector comparators, and reduce the risks that the Fund’s existing policies could undermine the quality and value for money of the audit. It was agreed to proceed with the upcoming mandatory rotation of the audit firm and that the policy could be revisited at a later date in light of experience. There was also significant support for opening the list of firms invited to bid for audit services to include the middle-tier firms.² The Ad Hoc Audit Selection Committee (ASC) will take these views into account in determining the list of firms that will be invited to bid in the upcoming selection of a new external auditor. Views on possible changes to the term and number of EAC members were mixed, but there was considerable support for measures to enhance the on-boarding process for new members. It is envisaged these measures will be implemented in the context of the selection of the next EAC member.

3. **This paper proposes to shift from a blanket prohibition on the provision of non-audit-related services to a blacklist approach.** The policy changes should be in place ahead of the upcoming mandatory rotation of the external audit firm. The paper includes a proposed decision to amend the Fund’s current policy to establish a blacklist of services that may not be provided by the external audit firm. This would allow the audit firm to perform consulting services not contained in the blacklist, subject to robust safeguards to ensure that the independence of the external audit firm is not compromised. A “bright line” of prohibited consulting services would remain in place, thereby maintaining strong standards for external auditor independence while allowing the audit firm to perform other non-audit-related services that do not compromise the independence of the external audit firm. The paper also proposes several additional safeguards for contracting non-prohibited consulting services: (i) an independence declaration by audit firms; (ii) limitations on the fees for audit-related and non-audit-related services, together referred to as “consulting services,” provided

¹ The blanket prohibition was implemented in 2004. See Attachment I reproducing the text of the Executive Board Decision No. 13323-(04/78), adopted August 5, 2004, as amended.

² Since the initial competitive bid in 1993, the Fund has only invited the top tier international audit firms to bid for the audit services.

by the audit firm; (iii) an oversight role for the EAC; and (iv) a review of consulting services provided by audit firms prior to the selection of a new external audit firm for the Fund.

4. The rest of the paper is organized as follows: The first section discusses the proposed blacklist of consulting services that would not be permitted to be performed by the Fund's external audit firm; the second section proposes additional safeguards to ensure the independence of the external audit firm regarding the provision of non-prohibited services; the third section discusses implementation modalities; and the last section sets forth the text of the proposed decision.

GUIDELINES ON PROHIBITED CONSULTING SERVICES

5. Many countries have put in place a framework for ensuring auditor independence that includes general guidance on services that can be performed by audit firms to an audit client and a list of specifically prohibited services. These guidelines typically stop short of the blanket prohibition on non-audit-related services implemented by the Fund in 2004 (see Attachment II).

6. The International Federation of Accountants (IFAC), as the global organization for the accountancy profession, has developed a Code of Ethics for Professional Accountants ("the code") that provides guidance on auditor independence. Rather than banning the provision of non-audit services by the audit firm to an audit client, the code specifies certain non-audit services that auditors of public companies should decide to refrain from providing to their audit clients. These include, for example, cases in which the auditor of the public company would (i) assume a management responsibility; (ii) provide accounting and bookkeeping services; and (iii) provide valuation services, if material to the financial statements. For the provision of any allowable consulting services, the code requires that adequate safeguards are implemented to ensure that the threat to the auditor's independence is reduced to an acceptable level.

7. In the United States, section 201 of the Sarbanes-Oxley Act of 2002 prohibits registered public accounting firms that perform an audit for any issuer to perform contemporaneously for that issuer certain non-audit services. The Act sets out a blacklist of nine services, which an external auditor is prohibited from providing to the audit client (Attachment II). Eight of these services refer to specific categories of activity while the ninth category is any other service deemed to be impermissible by regulation. The Act also requires that allowable consulting services be performed following the consent of the Audit Committee. Certain de minimus exceptions to the consent requirement are permitted.

8. In the European Union (EU), on April 3, the European Parliament adopted in a plenary session the amended Directive on Statutory Audit and the Regulation on specific requirements regarding the statutory audit of public interest entities (PIEs). Following the vote in plenary session, the audit package was formally adopted by the Council on April 14. The new legal framework allows for the provision of non-audit services with two main safeguards. First, there would be a prohibition on the provision of certain non-audit services to PIEs. Second, fees that can

be earned from the provision of non-audit services to PIEs in a fiscal year would be capped at 70 percent of the annual average audit fee during the last three years.³

9. Other countries such as China, Japan, and Mexico also permit the provision of non-audit services subject to a black list of prohibited services. The list of services in the blacklist is broadly similar to the services prohibited under the U.S. rules.

10. The proposed amendment to the Fund’s policy on consulting services would be consistent with global practices. It would recognize that some of the services provided by the large accounting firms would not be in conflict with external auditor independence, provided that adequate safeguards are put in place to mitigate potential threats to independence such as self review risk, self interest risk, and risk of assuming management responsibility.

11. The proposed blacklist of prohibited services is set out in Box 1. The rationale for including services in the blacklist is that these types of services could be subject to self review by the external auditor during the audit of the Fund’s financial statements and therefore may threaten or could be perceived to threaten the independence of the external audit firm. The external audit firm would be prohibited from providing services in the blacklist. Moreover, the external audit firm would also not be permitted to provide any other service not specifically identified on the blacklist, which could compromise the independence of the external audit firm. The blacklist was modeled on the lists of prohibited services in major jurisdictions. Similar to the ethical standards prescribed by the IFAC and rules in major jurisdictions, the external audit firm would not be allowed to provide services in which it would perform any management functions, nor be allowed to perform services in areas that could be subject to future audit procedures. The list may be amended from time to time by the Executive Board, in consultation with the EAC.

12. The guiding principle is that the external audit firm should not be engaged in services that could result in “self audit” or give rise to an actual or potential conflict of interest, or the appearance of a conflict of interest. The external audit firm must not perform services that would provide material input to the financial statements, support the development of systems that underpin the financial statements or impact the internal controls designed to protect the accuracy of the financial statements (see items 1-7 in Box 1). In addition, the external audit firm should not advise management on its investment strategy as it could affect its independence when reviewing the valuation of the investment portfolio. Similarly, the independence could be compromised if the external audit firm was allowed to provide certain human resources functions that would normally be a management function, such as recruitment services for senior executives. The external audit firm should also not perform legal or expert services as it cannot be an advocate for its client while at the same time maintaining the objectivity required for the audit.

³ The new rules are expected to be published in the Official Journal of the European Union in the second quarter of 2014. Member States will then have two years to adopt and publish the implementing provisions necessary to comply with the revised regulatory framework.

Box 1. Blacklist of Prohibited Consulting Services by the External Audit Firm

1. The provision of bookkeeping and accounting services.
2. The preparation of statements or schedules to be included in the financial statements.
3. The outsourcing of the finance or internal audit functions or parts thereof to the external audit firm.
4. The provision of appraisal or valuation and fairness opinions in relation to items, which may be included in the financial statements.
5. The provision of financial information systems design or implementation services of relevance to the financial statements.
6. Actuarial services that involve determining amounts recorded in the financial statements.
7. The design or implementation of internal controls in areas that could impact the financial statement audit of the Fund.¹
8. Acting as an investment advisor.
9. The performance of human resource functions that would normally be a management function.²
10. Legal and expert services in which the audit firm would act as an advocate for the Fund.

¹ The audit firm would be permitted to provide consulting services that are limited to giving recommendations for improvement in internal controls as these are subject to the Fund's final decision on implementation.

² The audit firm may provide advice on human resources matters. The prohibited services are those that would constitute a management function or taking on the role of managing the organization, such as the recruitment of senior staff in key financial or managerial positions.

ADDITIONAL SAFEGUARDS ON AUDITOR INDEPENDENCE

13. In addition to the blacklist on prohibited consulting services, staff proposes additional safeguards to ensure the independence of the external audit firm. These include (i) a declaration of independence by the current and prospective new audit firms; (ii) an upper limit on fees for consulting services provided by the external audit firm; (iii) an explicit oversight role for the EAC; and (iv) a review of consulting services provided by audit firms prior to the selection of a new external audit firm for the Fund.

A. Independence Declaration by Audit Firms

14. Audit firms have implemented internal mechanisms to ensure their independence as auditors. Under the current regulatory requirements, audit firms have robust internal processes in place that are designed to prevent them from providing consulting services that could compromise the independence required for the audit. The firms have systems of "threat-analysis" to determine whether services on which they are bidding pose a potential or actual conflict of interest. All audit firms have developed these types of processes and programs aimed at monitoring compliance with the independence requirements for professional staff and firms in their worldwide network.

15. The Fund’s external auditor would be requested to provide a declaration of independence to the Fund before being awarded a contract for consulting services. Such declaration would state whether the external audit firm would have actual and perceived independence if it were to be awarded the consulting engagement. It should also state that the external audit firm has adequate internal controls in place to identify existing and potential threats to auditor independence. A sample declaration is provided in Attachment III.

16. Similarly, audit firms that could be eligible for future Fund audit contracts would be expected to provide a declaration of independence to the Fund. This would ensure that independence issues for prospective audit firms are identified in advance of the selection of the new audit firm. A sample declaration is included in Attachment III.

B. Limit on the Fees for Consulting Services Provided by the External Audit Firm

17. A limit on the consulting fees that could be earned relative to the audit fees would serve to mitigate any perception that an auditor’s independence may be impaired by large-scale consulting engagements. Under the current Fund policy, the external auditor can earn fees for audit-related consulting services up to a maximum of 33 percent of the value of the five-year audit contract. It is proposed to widen the scope of the services subject to the cap to include all consulting services (i.e., audit-related and non-audit related consulting services) and increase the fee cap from 33 percent to 70 percent. Specifically, the total consulting fees earned by the external audit firm over the term of the audit contract should not exceed 70 percent of the audit fees to be earned over that same contract term.⁴ The 70 percent cap would provide sufficient scope for departments to engage the external audit firm in consulting services, while ensuring the audit contract would remain the primary focus of the external auditor.⁵

18. It is further proposed that the 70 percent limit could be exceeded on an exceptional basis, with the approval of the Executive Board, in circumstances where the audit firm would be considered the most qualified provider for new or amended consulting services contracts. Services that would exceed the limit could only be contracted with prior Executive Board approval and after a written opinion of the EAC to the Executive Board regarding the impact of such contract on the independence of the external audit firm. Under no circumstances, however, should the cumulative consulting fees exceed 100 percent of the total audit fees over the term of the audit contract. This approach would ensure that fees from consulting services would not be greater than the total audit fees earned over the term of the audit contract since the focus on audit services should remain the primary priority of the Fund’s external audit firm. Analysis by staff shows that the

⁴ Where the consulting contract of the current or prospective audit firm commences prior to or extends beyond the audit contract period, the consulting fees would be prorated when calculating the fee cap.

⁵ The 70 percent cap is also aligned with the fee cap proposed in the recent audit reforms in the EU.

fees for consulting services provided by large audit firms in recent years have been below the 70 percent fee cap (see Attachment IV).

C. Oversight by the EAC

19. As a further safeguard, it is proposed that the EAC, as part of its general oversight over the external audit, be involved in ensuring that the provision of consulting services would not threaten the independence of the audit firm. The EAC plays a key role in the Fund's governance structure in providing independent general oversight of the external audit process.⁶ Consistent with this role, it is proposed that the EAC would be requested to review any proposals for the provision of consulting services by the Fund's external audit firm, in order to assess whether or not the services could compromise the independence of the external audit firm before any contract for such services is finalized.⁷

Specifically, the EAC would:

- **Review proposals for the provision of consulting services by the external audit firm except for those already determined to be disallowed due to being on the blacklist.** All non-blacklist services would need to be reviewed by the EAC before any contract is finalized, including the declaration of independence letters received by the audit firm. For contracts within the 70 percent cap, no contract should be entered into unless the EAC confirms that the proposed services would not compromise the independence of the external audit firm. For contracts that would bring fees above the 70 percent limit (new contracts or amendments to existing contracts that would increase the auditor fees), staff proposes that the EAC be asked to provide a written opinion to the Executive Board regarding the consistency of such contracts with auditor independence. The final decision would be taken by the Executive Board. For each proposed service, staff would submit an analysis to the EAC including the nature and scope of services to be performed as well as the rationale for staff determination as to whether or not the proposed services could impair the auditor's independence.⁸
- **Report annually to the Executive Board.** The external auditor is required by the auditing standards to confirm its independence on an annual basis to the EAC. As part of its year-end oversight work, the EAC would (i) review this independence letter to ensure that all requirements for auditor independence are met; (ii) report to the Executive Board the fees paid to the external audit firm for audit services as well as any consulting services provided by the external audit firm; and

⁶ Section 20 (c) By-Laws of the Fund. While not involved in formal approval processes, the EAC has general oversight of the annual audit and transmits the audited financial statements, through the Managing Director and the Executive Board, to the Board of Governors for consideration. In addition, the external audit firm is selected by the Executive Board in consultation with the EAC and appointed by the Managing Director.

⁷ The EAC chair will coordinate the review of the proposals with the other EAC members. The EAC is accustomed to coordinating its work across geographic regions throughout the year.

⁸ Past experience suggests the number of contracts requiring EAC review is unlikely to be more than three in any one year.

(iii) confirm that any consulting services contracted from the external audit firm during the financial year, which did not require Executive Board approval, do not compromise the independence of the audit firm.

D. Review of Consulting Services by Audit Firms Prior to the Selection of a New External Audit Firm

20. Consulting services provided to the Fund by audit firms would be reviewed before the selection of a new external audit firm to rule out concerns about the independence of a new audit firm. As a first step, staff would review all consulting services being provided to the Fund (as well as those provided in the previous fiscal year), by the audit firms that the Ad Hoc Audit Selection Committee identified as potential bidders for the external audit firm contract and would assess if the services could compromise the independence of the firm if it was appointed as the Fund's external auditor. Such assessment would also consider the fees to be earned under existing consulting contracts to ensure that they would stay within the limits discussed above. Staff would provide its assessment to the EAC. When the EAC is consulted prior to the selection of a new external audit firm that has existing consulting contracts with the Fund, the EAC would be asked to provide its opinion whether any such contracts would compromise the independence of the external audit firm.⁹

IMPLEMENTATION MODALITIES AND EAC VIEWS

Implementation Modalities

21. Implementation of the new framework will require close coordination among staff (particularly TGS procurement and FIN) in several areas including (i) identification of audit firms potentially eligible for a future Fund audit contract; (ii) clarification of any questions on the list of blacklisted services; (iii) assessment of consistency with the fee cap; and (iv) coordination of the preparation of the declaration of independence. This would be needed both to ensure that any contracts for consulting services by the existing audit firm are in compliance with the policy, and that potential future bidders for the Fund's audit, that meet the policy requirements of the new proposed framework, are not inadvertently excluded in the period leading up to the auditor rotation, currently required every ten years.¹⁰ Staff is working on operational modalities to implement the proposed new framework.

22. It is intended that the new framework would be applied for the upcoming external audit firm rotation. Staff would analyze all existing consulting services performed by audit firms identified as potential bidders by the Ad Hoc Audit Selection Committee, to determine if any

⁹ The EAC is consulted on the selection of the external audit firm in accordance with Section 20(c) of the Fund's By-laws.

¹⁰ A potential bidder may be inadvertently excluded from the bidding process if an allowable consulting service is mistakenly considered as a blacklisted consulting service. As such, close coordination among staff is important to properly identify blacklisted services.

independence issues would be likely to arise if one of the firms were to be appointed as the Fund's external auditor. To guard against the risk of self audit, the review would ensure that none of the potential bidders have performed a blacklisted service for the Fund during the current and previous financial years of the Fund.¹¹ As discussed in paragraph 20, similar stock-taking due diligence would take place ahead of any subsequent solicitations.

The EAC views

23. Staff sought the views of the EAC on the proposed changes to the policy on the provision of consulting services by the external audit firm. Overall, the EAC supports the staff proposal and is of the view that the proposed safeguards are adequate to protect the independence of the external audit firm, if it was to provide consulting services to the Fund. The EAC also emphasized that additional measures to strengthen the EAC, such as prolonging the term and/or increasing the number of EAC members, are desirable in light of the potential increased demand on the EAC to evaluate the independence of the external audit firm.

¹¹ The external auditor's opinion covers the current year and prior year financial statements.

Proposed Decision

Accordingly, the following decision, which may be adopted by a majority of the votes cast, is proposed for adoption by the Executive Board:¹²

Decision No. 13323-(04/78) adopted August 5, 2004 as amended, regarding the mandatory rotation of the external audit firm and the limits on the provision of audit-related and non-audit-related services shall be further amended as follows:

Paragraph 3 Shall be Amended to Read as Follows:

- “3.The Fund’s external audit firm may provide consulting services to the Fund subject to the following conditions:
 - (i) The services are not included in the list of prohibited consulting services set out in Box 1 of EBAP/14/46 and would not otherwise compromise the independence of the external audit firm.
 - (ii) The external audit firm shall provide a written declaration confirming that the provision of the proposed consulting services to the Fund would not compromise its independence as the external audit firm.
 - (iii) The total consulting fees of the external audit firm for the term of the audit contract shall not exceed 70 percent of the audit fees over the same period. Prior to entering into contracts that are within this limit, the EAC shall be consulted and confirm that the proposed services would not compromise the independence of the external audit firm.
 - (iv) In exceptional circumstances, and with the approval of the Executive Board, the total fees may exceed the limit under (iii) above, provided that under no circumstances they shall exceed 100 percent of the audit fees for the period of the audit contract. Prior to any Executive Board decision approving such services, the EAC shall provide a written opinion to the Executive Board on the consistency of the proposed services with the independence of the external audit firm.
 - (v) In its reporting to the Executive Board on the external audit, the EAC shall report the fees paid to the external audit firm for audit services and any consulting services, and

¹² The proposed decision deletes paragraph 4 of Decision No. 13323-(04/78), which provided a transitional arrangement to authorize PricewaterhouseCoopers, the Fund’s external audit firm in 2004, to complete existing contracts with the Fund executed prior to the establishment of the blanket prohibition on non-audit related consulting services.

confirm that the consulting services by the external audit firm contracted during a financial year that did not require Executive Board approval do not compromise the independence of the external audit firm.

(vi) As part of the consultation of the EAC prior to the selection of a new external audit firm, the EAC shall provide an opinion whether existing consulting contracts of an audit firm could compromise the independence of the external audit firm if it was to be selected as the external audit firm.”

Paragraph 4 shall be deleted.

Attachment I. Decision No. 13323–(04/78), as Amended

1. The contract to conduct the annual external audit of the financial statements of the Fund required under Article XII, Section 7(a) of the Fund’s Articles of Agreement and Section 20 of the Fund’s By-Laws shall be for a 5-year term and may be renewed for up to an additional five years.
2. The Fund’s external audit firm shall be rotated at least every 10 years. In cases where the Fund’s external audit firm is awarded a second contract after the first 5-year period, the new contract will require that the audit firm shall, if and in the manner directed by the Fund, rotate the engagement partner and the audit manager.
3. The Fund’s external audit firm shall not be eligible to bid for, and shall not be awarded, the provision of non-audit-related consulting services to the Fund. The provision of audit-related consulting services to the Fund by the Fund’s external audit firm shall be subject to the prior approval of the Executive Board after consultation with the External Audit Committee (EAC), provided that, under no circumstances, shall the remuneration of the Fund’s external audit firm for such services exceed 33 percent of the value of the five year contract for conducting the annual audit of the financial statements of the Fund.
4. This decision shall not preclude the Fund’s external audit firm from submitting in accordance with this decision and completing any other existing contracts with the Fund.

Decision No. 13323–(04/78) Adopted August 5, 2004, amended July 21, 2009

Attachment II. Comparison of the Restrictions on the Provision of Non-Audit Services between Selected Countries

Brazil	The independent auditor may not render non-audit services to a public entity that could result in the loss of objectivity and independence. Examples of non-audit services are: 1) Advisory services on organizational restructuring; 2) Evaluation of companies; 3) Revaluation of assets; 4) Assessment of amounts in view of the recoding of provisions; 5) Tax planning; 6) Redesign of accounting information and internal control systems; and 7) Any other product of service that could influence management decisions in the audited entity.
China	Except in emergency situations or rare cases, a firm shall not provide to an audit client that is a public interest entity the following accounting and bookkeeping services: 1) Payroll services; 2) Prepare financial statements that will be audited; 3) Prepare financial information which forms the basis of the financial statements; 4) A firm shall not prepare tax calculations of current and deferred tax liabilities (or assets) for the purpose of preparing accounting entries that are material to the financial statements that will be audited. 5) A firm shall not provide internal audit services that relate to: (a) The internal controls over financial reporting; (b) Financial accounting systems; or (c) Amounts or disclosures that are material to the financial statements that will be audited.
Japan	The amended CPA Law prohibits the following non-audit services: 1) Services related to bookkeeping, financial documents, accounting books; 2) Design of financial or accounting information systems; 3) Services related to appraisal of the contribution-in-kind reports; 4) Actuary services; 5) Internal audit outsourcing services; 6) Securities brokerage services; 7) Investment advisory services; 8) Other services that are equivalent to the above listed services, which may involve management decisions or lead to self-audit of the financial documents the auditor examines. These non-audit services are prohibited to any clients that are required to be audited in accordance with the Financial Instruments and Exchange Act (FEIA) and certain large companies that are required audits by the Companies Act.
Mexico	The Circular Unica lists the following non-audit services as an infringement on the auditor's independence: 1) Preparation of financial statements and accounting records or bookkeeping; 2) Direct or indirect operation of the firm's financial information systems; 3) Supervision, design or implementation of the computer systems (hardware and software); 4) Valuation or estimates that are, individually or as a whole, of relevance for the financial statements examined by the auditor (except estimates related to transfer pricing for tax purposes); 5) Temporary or permanent involvement in the firm's decision making; 6) Recruitment and selection of management staff; 7) Involvement in the internal audit; 8) Preparation of opinions that under the provisions of Mexican financial system should be prepared by licensed legal experts; 9) Other services that could cause conflict of interest in relation to the work of the external audit.
EU	The 2014 draft EU law would prohibit audit firms from providing non-audit services that could jeopardize independence; a list of prohibited services is being developed. There is currently no EU-wide ban preventing auditors from offering non-audit services (NAS) to audit clients. According to Article 22 of the Statutory Audit Directive, audit should not be provided in cases where "an objective, reasonable and informed third party would conclude that the statutory auditor's or audit firm's independence is compromised". If the audit firm's independence is affected by threats such as self-review, self-interest and advocacy, the audit firm must apply safeguards to mitigate such threats. Article 22 stipulates only the broad independence principles and, given the Member States' discretion, it has so far been implemented in a very divergent manner across the EU. For example, in France there is a ban on the provision of NAS from any member of the auditor's network to any member of the audited company's group. In Belgium, there is also a strict framework for the provision of NAS. In the other Member States, rules are less restrictive and the provision of NAS by auditors to the companies they audit remains commonplace. Auditors and audit committees have great flexibility in determining whether the provision of NAS results in a conflict of interests.
USA	Section 201(a) of the Sarbanes-Oxley Act states that it shall be unlawful for a registered public accounting firm that performs an audit of a public company's financial statements to provide to that issuer, contemporaneously with the audit, any non-audit services, including the following nine categories of services: 1) Bookkeeping or other services related to the accounting records or financial statements of the audit client; 2) Financial information systems design and implementation; 3) Appraisal or valuation services, fairness opinions, or contribution-in-kind reports; 4) Actuarial services; 5) Internal audit outsourcing services; 6) Management functions or human resources; 7) Broker or dealer, investment adviser, or investment banking services; 8) Legal services and expert services unrelated to the audit; 9) Any other service that the Board determines, by regulation, is impermissible.

Attachment III. Sample Declaration of Independence by the Current or Prospective Audit Firm

Sample 1: Current or Prospective Audit Firm—Without Independence Issues

We confirm that the services set out in the proposed engagement do not compromise the independence of our role or potential future role as external auditor of the International Monetary Fund. We confirm the provision of such services complies with the policy of the International Monetary Fund governing the independence of the external auditor and complies with the guidance on auditor independence contained in the IFAC Code of Ethics for Accountants. We have adequate internal controls in place to identify existing and potential threats to auditor independence.

Signed:

Date:

Sample 2: Prospective Audit Firm—With Potential Independence Issues

We hereby inform the International Monetary Fund (IMF) that the services set out in the proposed engagement may compromise our independence as potential future external auditor of the IMF. Although not included in the list of prohibited services under the Fund's policy governing the independence of the external auditor, in our opinion, the proposed services raise significant threats of self review risk, self interest or advocacy, if we were to be appointed as the Fund's external auditor. We have adequate internal controls in place to identify existing and potential threats to auditor independence.

Signed:

Date:

Attachment IV. Analysis of Consulting Fees FY 2010–2014

Analysis of Consulting Fees For the Financial Years 2010–2014¹		
Firm	Amount (USD millions)	Consulting Fees as a Percent of Audit Fees³
Total audit fees ²	5.78	-
Ernst & Young total consulting fees	1.70	29
Grant Thornton total consulting fees	1.40	24
KPMG total consulting fees	0.77	13
PricewaterhouseCoopers total consulting fees	2.24	39

Source: Procurement & Strategic Budget Management Division data and FIN calculations.

¹ Data provided as of April 25, 2014.

² Deloitte & Touche is the current external auditor of the Fund.

³ Consulting fees have been prorated where the consulting contract term commences prior to FY2010 or ends after FY2014.

Proposed Decision

Decision No. 13323-(04/78) adopted August 5, 2004 as amended, regarding the mandatory rotation of the external audit firm and the limits on the provision of audit-related and non-audit-related services shall be further amended as follows:

1. Paragraph 3 shall be amended to read as follows:

"3. The Fund's external audit firm may provide consulting services to the Fund subject to the following conditions:

- (i) The services are not included in the List of Prohibited Consulting Services by the External Audit Firm that is annexed to this Decision and would not otherwise compromise the independence of the external audit firm.
- (ii) The external audit firm shall provide a written declaration confirming that the provision of the proposed consulting services to the Fund would not compromise its independence as the external audit firm.
- (iii) The total consulting fees of the external audit firm for the term of the audit contract shall not exceed 70 percent of the audit fees over the same period. Prior to entering into contracts that are within this limit, the EAC shall be consulted and confirm that the proposed services would not compromise the independence of the external audit firm.
- (iv) In exceptional circumstances, and with the approval of the Executive Board, the total fees may exceed the limit under (iii) above, provided that under no circumstances they shall exceed 100 percent of the audit fees for the period of the audit contract. Prior to any Executive Board decision approving such services, the EAC shall provide a written opinion to the Executive Board on the consistency of the proposed services with the independence of the external audit firm.
- (v) In its reporting to the Executive Board on the external audit, the EAC shall report the fees paid to the external audit firm for audit services and any consulting services, and confirm that the consulting services by the external audit firm contracted during a financial year that did not require Executive Board approval do not compromise the independence of the external audit firm.
- (vi) As part of the consultation with the EAC prior to the selection of a new external audit firm, the EAC shall provide an opinion whether existing consulting contracts of an

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audit firm could compromise the independence of the external audit firm if it was to be selected as the external audit firm.”

2. Paragraph 4 shall be deleted.

Annex

List of Prohibited Consulting Services by the External Audit Firm

1. The provision of bookkeeping and accounting services.
2. The preparation of statements or schedules to be included in the financial statements.
3. The outsourcing of the finance or internal audit functions or parts thereof to the external audit firm.
4. The provision of appraisal or valuation and fairness opinions in relation to items, which may be included in the financial statements.
5. The provision of financial information systems design or implementation services of relevance to the financial statements.
6. Actuarial services that involve determining amounts recorded in the financial statements.
7. The design or implementation of internal controls in areas that could impact the financial statement audit of the Fund¹
8. Acting as an investment advisor.
9. The performance of human resource functions that would normally be a management function.²
10. Legal and expert services in which the audit firm would act as an advocate for the Fund.

¹ The audit firm would be permitted to provide consulting services that are limited to giving recommendations for improvement in internal controls as these are subject to the Fund's final decision on implementation.

² The audit firm may provide advice on human resources matters. The prohibited services are those that would constitute a management function or taking on the role of managing the organization, such as the recruitment of senior staff in key financial or managerial positions.

MODIFICATION OF THE POLICY ON PROVISION OF CONSULTING SERVICES BY THE EXTERNAL AUDIT FIRM

Redlined Version Decision 13323 (04-78)

The contract to conduct the annual external audit of the financial statements of the Fund required under Article XII, Section 7(a) of the Fund's Articles of Agreement and Section 20 of the Fund's By-Laws shall be for a 5-year term and may be renewed for up to an additional five years.

2. The Fund's external audit firm shall be rotated at least every 10 years. In cases where the Fund's external audit firm is awarded a second contract after the first 5-year period, the new contract will require that the audit firm shall, if and in the manner directed by the Fund, rotate the engagement partner and the audit manager.

~~3. The Fund's external audit firm shall not be eligible to bid for, and shall not be awarded, the provision of non-audit-related consulting services to the Fund. The provision of audit-related consulting services to the Fund by the Fund's external audit firm shall be subject to the prior approval of the Executive Board after consultation with the External Audit Committee (EAC), provided that, under no circumstances, shall the remuneration of the Fund's external audit firm for such services exceed 33 percent of the value of the five-year contract for conducting the annual audit of the financial statements of the Fund.~~

3. The Fund's external audit firm may provide consulting services to the Fund subject to the following conditions:

- (i) The services are not included in the List of Prohibited Consulting Services by the External Audit Firm that is annexed to this Decision and would not otherwise compromise the independence of the external audit firm.
- (ii) The external audit firm shall provide a written declaration confirming that the provision of the proposed consulting services to the Fund would not compromise its independence as the external audit firm.
- (iii) The total consulting fees of the external audit firm for the term of the audit contract shall not exceed 70 percent of the audit fees over the same period. Prior to entering into contracts that are within this limit, the EAC shall be consulted and confirm that the proposed services would not compromise the independence of the external audit firm.
- (iv) In exceptional circumstances, and with the approval of the Executive Board, the total fees may exceed the limit under (iii) above, provided that under no circumstances they shall exceed 100 percent of the audit fees for the period of the audit contract. Prior to any Executive Board decision approving such services, the EAC shall provide a written opinion to the Executive Board on the consistency of the proposed services with the independence of the external audit firm.

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(v) In its reporting to the Executive Board on the external audit, the EAC shall report the fees paid to the external audit firm for audit services and any consulting services, and confirm that the consulting services by the external audit firm contracted during a financial year that did not require Executive Board approval do not compromise the independence of the external audit firm.

(vi) As part of the consultation with the EAC prior to the selection of a new external audit firm, the EAC shall provide an opinion whether existing consulting contracts of an audit firm could compromise the independence of the external audit firm if it was to be selected as the external audit firm."

4. ~~This decision shall not preclude the Fund's current external audit firm from submitting bids in accordance with this decision and completing any other existing contracts with the Fund.~~

Annex. List of Prohibited Consulting Services by the External Audit Firm

1. The provision of bookkeeping and accounting services.
2. The preparation of statements or schedules to be included in the financial statements.
3. The outsourcing of the finance or internal audit functions or parts thereof to the external audit firm.
4. The provision of appraisal or valuation and fairness opinions in relation to items, which may be included in the financial statements.
5. The provision of financial information systems design or implementation services of relevance to the financial statements.
6. Actuarial services that involve determining amounts recorded in the financial statements.
7. The design or implementation of internal controls in areas that could impact the financial statement audit of the Fund³
8. Acting as an investment advisor.
9. The performance of human resource functions that would normally be a management function.⁴
10. Legal and expert services in which the audit firm would act as an advocate for the Fund.

³ The audit firm would be permitted to provide consulting services that are limited to giving recommendations for improvement in internal controls as these are subject to the Fund's final decision on implementation.

⁴ The audit firm may provide advice on human resources matters. The prohibited services are those that would constitute a management function or taking on the role of managing the organization, such as the recruitment of senior staff in key financial or managerial positions.