

THE EXTERNAL AUDITOR OF A BANKING CORPORATION

Introduction

1. The provisions of this regulation shall apply to the external auditor of a banking corporation in addition to the provisions of the Companies Law, 5759 - 1999 and the Accountants Law, 5715 - 1955 and the regulations introduced under it.
2. The external auditor shall be independent of the banking corporation being audited. For this purpose, "**independent**" is as defined in the Certified Public Accountants (Conflict of Interest and Infringement of Independence due to Outside Activity) (interim provision) Regulations, 5763-2003, in the Supervisor of Banks directives regarding Conflict of Interest and Infringement of Independence due to Outside Activity of External Auditor of Banking Corporation (see appendix A), and in the ruling of the Securities Authority under section 9b of the Securities Law, 5728–1968, published in August 1992 (see appendix B).

Appearance before the board of directors

3. The external auditor of a banking corporation shall be entitled, at his request, to appear before the board of directors or the audit committee on any subject that is within the sphere of his position.

Replacing the external auditor

4. At least once every three years, or when the term for which the external auditor has been appointed ends, whichever is later, the audit committee shall discuss the possibility of replacing the banking corporation's external auditor.
 - 4a. (a) The external auditor:
 - (1) Shall appoint a partner responsible for the audit of each banking corporation.
 - (2) Shall appoint a partner responsible for the annual review of the audit of each banking corporation

- (b) A partner responsible for the audit and a partner responsible for the annual review of the audit (henceforth, “the responsible partners”) shall not perform these duties for longer than five consecutive years. At the end of that period the responsible partners shall be replaced by other responsible partners. The responsible partners who have been replaced may resume their positions as a partner responsible for the audit of a banking corporation or as a partner responsible for the annual review of the audit of a banking corporation only if 5 consecutive years have passed since they were replaced.
- (c) In exceptional circumstances the Supervisor of Banks shall consider a detailed request to depart from the above, for a period to be determined by him.

For the purpose of this section:

“**A partner responsible for the audit**” is the partner who is responsible for conducting the audit and who signs the external auditor’s opinion on the financial report of the banking corporation.

“**A partner responsible for the annual review of the audit,**” is a partner who is not connected with the audit of the specific banking corporation, and who shall prepare a documented annual review of the audit in order to ascertain whether the control mechanisms intended to ensure the objectivity and independence of the audit needs to be reinforced, *inter alia* by replacing the banking corporation’s auditing team, including the partner responsible for the audit.

Transferring information to the external auditor

5. (a) The general manager shall transfer to the external auditor on an ongoing basis every audit report that concerns the subjects which are within the external auditor’s sphere of responsibility and is addressed to the banking corporation by the Supervisor of Banks, as well as the comments and replies to the report and the ensuing correspondence. Similarly, the external auditor shall receive, at his request, audit report of the Supervisor of Banks.
- (b) The general manager shall transfer to the external auditor on an ongoing basis every audit report, which is prepared by the internal auditor and is within the external auditor’s sphere of responsibility.

Reporting by the external auditor

6. (a) The external auditor must report to the board of directors, by means of the chairman of the board of directors, and to the general manager any action of the banking corporation regarding which he has received information and which appears to him to deviate substantially from proper conduct or constitute a violation of the law or a serious infringement of the rights of the banking corporation's lenders, customers, or shareholders of the banking corporation.
- (b) The external auditor shall transfer to the Supervisor of Banks, by means of the chairman of the board of directors, audit reports he has prepared which concern the banking corporation and which he regards as being of interest to the Supervisor of Banks.
- (c) If the external auditor reaches the conclusion that there are doubts as to the continued existence of the banking corporation as a going concern in the foreseeable future, he shall report this immediately to the chairman of the board of directors and to the Supervisor of Banks together with all the reasons for this conclusion.

Appendix A

Guidelines concerning Conflict of Interest and Infringement of Independence due to Outside Activity of External Auditor of Banking Corporation

Definitions:

1. In these guidelines—
 - “Audit”— As denoted in the Certified Public Accountants (Modus Operandi of Certified Public Accountant) Regulations, 5733-1973;
 - “Family member”— An offspring, spouse, brother, sister, parent, and spouse's of all of these;
 - “Holding” and “Control”— As denoted in the Securities Law, 5728-1968, hereinafter: the Securities Law;
 - “Officer” and “Security”— As denoted in the Companies Law, 5759-1999;
 - “Client”— The audited entity and any party that controls the audited entity. If consolidated statements are prepared for the audited entity, in the sense of this term in the Generally Accepted Accounting Principles—then also any consolidated and materially company included on the equity basis. For this purpose, a "**materially company included on the equity basis**" is a company in which the audited entity has invested at least 5 percent of its total assets and in which the share of the audited entity in net income (loss) from ordinary operations exceeds 5 percent of net income (loss) of the ordinary operations of the audited entity;

- “Audited entity”**— A banking corporation or an auxiliary corporation that issues financial statements audited by an external auditor;
- “Audit firm”**— An external auditor as well as the auditors who are employed by him or by an accounting firm in which he is a partner or a member;
- “Outside activity”**— Including by means of a corporation controlled by an external auditor. For this purpose, **"control"** includes the assumption that anyone who has a 25 percent controlling means in a corporation and the ability to thwart the adoption of business decisions in the corporation, controls the corporation;
- “Relative”**— A family member who shares a domicile with the person, a person who derives his livelihood from said person, one who provides said person with his livelihood, and a corporation controlled by any of them, or a trustee on behalf of any of them;
- “External auditor”**— An auditor who is appointed to audit a certain audited entity, including the auditors who are partners, members, or shareholders in an accounting corporation in which he is an employee, partner, member, or shareholder, and also anyone who engages in auditing the audited entity on his behalf;
- “Auditor-in-charge”**— an external auditor who actually performs the audit of the audited entity;
- “Banking corporation”** as denoted in the Banking (Licensing) Law,

- and “auxiliary corporation”**— 5741-1981;
- “Accounting firm”**— a corporation or a partnership of CPAs
- “Audit period”**— the current period for which the audit is being performed, including the period up to the date on which the external auditor submits his opinion about the financial statements for the current period.

Circumstances of Possible Conflict of Interest or Infringement of Independence

2. (a) It is assumed that an external auditor is in conflict of interest or that his independence with regard to the audited entity has been impaired if, within the framework of the audit that he is conducting, he is asked:
- (1) To audit a business or a transaction in which he has a personal interest or an opinion or valuation that he has given in the course of outside activity; however, no such presumption will be seen in regard to an economic opinion that the external auditor gave before the beginning of the audit period for which he was appointed as the external auditor of the audited entity.
 - (2) To operate as a member of management or as an employee of the audited entity;
 - (3) To act as an advocate of the audit entity, with the exception of tax authorities representation; "A ... auditor, to be independent, should not act as an advocate of its audit client (as it would if it provided legal and expert services to an audit client in judicial or regulatory proceedings)."
 - (4) To promote a share issue or other financial interests of the audited entity.
- (b) In addition to the provisions of the foregoing subsection, it is presumed that an action by an external auditor, within the framework of his outside activity, is an act of conflict of interest or impairment of auditor independence in the audited entity if one of the following is present:

- (1) He receives from the client, on account of the audit period, a wage, a wage undertaking, or other benefit conditioned on the results of his auditing actions;
- (2) He has conditioned his handling of the audit on being employed in an outside activity;
- (3) He or his relative has maintained, directly or indirectly, including by means of a corporation under their control, an economic relationship with the client during the audit period or in the year preceding it; For this purpose, an “**economic relationship**” includes supplier–customer relations, service provider–service recipient relations, commercial brokerage, leasing of assets, business partnership, joint ventures, partnership in assets, etc. However, the receipt of a wage from the client shall not be considered an economic relationship;
- (4) He or his relative received a loan from the client, except for loans of the types listed below, received by an external auditor or his relative except for an auditor-in-charge or his relative, from a banking corporation under market conditions and in the course of the client’s ordinary business, with all ordinary procedures, conditions, and requirements at the banking corporation upheld at the time the loans were given:
 - (a) automobile loan and leases collateralized by the automobile;
 - (b) Loans fully collateralized by the cash-surrender value of an insurance policy;
 - (c) A loan fully collateralized by a cash deposit with the same banking corporation;
 - (d) A housing loan collateralized by the borrower’s principal residence, provided that the loan was given to the borrower before he became an external auditor of the client;
 - (e) A loan to an external auditor or his relative, apart from an auditor-in-charge or his relative, by a client that is a credit-card company, under market conditions and in the ordinary course of the client’s business, with all ordinary procedures, conditions, and requirements of the banking corporation upheld at the time the loans were given, and provided that on the credit date the amortized balance of the loan does not exceed

NIS 25,000. Notwithstanding the foregoing, a current credit-card balance shall not be considered an economic relationship. (“Any aggregate outstanding credit-card balance owed to a lender that is an audit client that is not reduced to \$10,000 or less on a current basis, taking into consideration the payment-due date and any available grace period.”)

For the purpose of this subsection, an “**external auditor**” excludes a person who operates permanently in another country.

- (5) He or his relative made a deposit with the client, except a deposit in which one of the following conditions is present:
- (a) A deposit by an individual external auditor with the banking corporation, if the sum of the deposit does not exceed NIS 250,000;
 - (b) A deposit by an accounting firm with a banking corporation, provided that the probability of the occurrence of financial difficulties at the banking corporation is remote.

For the purpose of this subsection, an “**external auditor**” excludes a person who operates permanently in another country.

- (6) He or his relative gave the client a loan or a guarantee.

For the purpose of this subsection, a “**client**” includes a company included on the equity basis in the financial statements, an officer in one of the companies, or a principal in the audited entity, as denoted in the Securities Law.

- (7) He or his relative holds securities of the client at any proportion.

For the purpose of this subsection, a “**client**” includes a company included on the equity basis in the financial statements, as denoted in the Securities Law; an “**external auditor**” excludes a person who operates permanently in another country.

- (8) A family member who is not a relative holds securities at the rate of 5 percent or more in the client.

For the purpose of this subsection, an “**external auditor**” excludes a person who operates permanently in another country.

- (9) The external auditor or a person involved in some way in discussions pertaining to the audit of the audited entity, including discussions among partners in the

audit firm, is or was an employee of said client or is employed by the client in some other way, and an employer-employee relationship exists between the client and said external auditor, during the audit period or in the year preceding it.

For the purpose of this subsection, a “**client**” includes an officer or a principal in the audited entity, as denoted in the Securities Law.

- (10) A person from the audit firm participated or is participating, during the audit period, in making management decisions for the client.

Outside Activities

3. Without derogating from the generality of the provisions in Section 2, it is presumed that an external auditor is in a state of conflict of interest or that his independence as an auditor has been impaired if he engaged or is engaging, during the audit period or in the year preceding it, in an outside activity, as follows:

- (1) An attorney, as denoted in the Bar Association Law, 5721-1961, for the client, except for actions customarily performed by an accountant;
- (2) A person from an audit firm who serves as a liquidator, receiver, estate executor, or trustee of the client, of a company that has material business relations with the audited entity, or holdings of a principal in the audited entity, except for a trust in which said trustee carries out income-tax instructions in regard to trust assets without making executive decisions;

For the purpose of this subsection, a “**principal**” is as denoted in the Securities Law.

- (3) Tendering an opinion on the client’s financial statements, where the statements include details based on an opinion of a person from the audit firm in one or more of the following contexts:
 - (a) Economic valuation of assets, including automobile adjusting and land valuation;
 - (b) Economic valuation of liabilities;
 - (c) The existence of rights in assets or the existence of liabilities;
 - (d) Evaluation of the actual state of assets;
 - (e) Preparation of business plan that affects the life of the business;
 - (f) Fairness opinions or contribution-in-kind reports;

except where it is reasonable to state that the results of these services will not be subjected to audit procedures during the audit of the audited entity's financial statements.

- (4) Valuation of the audited entity, except if not performed for the audited entity, and in which all of the following, in cumulative terms, are present:
 - (a) The valuation was performed before the beginning of the audit period;
 - (b) The valuation was performed for a party that was not a controlling principal in the audited entity at the time that it was performed.
- (5) Serving as an internal auditor of the client or on behalf of the internal auditor as part of his function as the client's internal auditor; outsourcing of internal auditing services that are related to the internal accounting controls, financial system or financial statements of the audited entity, except where it is reasonable to state that the results of these services will not be subjected to audit procedures during the audit of the audited entity's financial statements.
- (6) Service of a person from the audit firm as an officer in a corporation that is a client; and service of a relative or family member of the external auditor, unless the external auditor was unaware thereof; for this purpose, the auditor shall be deemed to be aware even if he suspected that such was the case and refrained from confirming said suspicion.
- (7) Regular activity on behalf of the audited entity as an investment consultant or an investment-portfolio manager; for this purpose, **"investment consultant"** and **"investment-portfolio manager"** shall be construed as in the Regulation of Investment Consulting and Investment-Portfolio Management Occupation Law, 5755-1995; provision of investment-banking services for the audited entity, serving as a broker-dealer, promoter, or underwriter for the audited entity, making investment decisions on behalf of the audited entity or having discretionary power in regard to investments of the audited entity, performing investment sale or purchase transactions for the audited entity, or safeguarding assets of the audited entity, including temporary holding of securities acquired by the audited entity.
- (8) Providing bookkeeping or other services related to the records of account or financial statements of the audited entity. Any service, except where it is reasonable to state

that the results of said service will not be subjected to audit procedures during the audit of the audited entity's financial statements, including:

- (a) Maintenance or preparation of records of account of the audited entity;
 - (b) Preparation of financial statements of the audited entity that are submitted to the Supervisor of Banks or that are used as a basis for said statements;
 - (c) Preparation or creation of information that serves as a basis for the financial statements of the audited entity.
- (9) Design and application of computer information systems related to financial reporting by the audited entity. Any service, except where it is reasonable to state that the results of said service will not be subjected to audit procedures during the audit of the audited entity's financial statements, including:
- (a) Direct or indirect operation, or inspection of operation, of information systems of the audited entity, or management of a local network of the audited entity;
 - (b) Design or application of hardware or software systems that gather data on which the financial statements of the audited entity are based or that generate information that is material for the financial statements of the audited entity or for other accounting information systems of the audited entity, at large.
- (10) Provision of actuarial services for the audited entity. Any consulting services of actuarial orientation that entail the determination of sums to be entered in financial statements and other reports of the audited entity, except for assistance to the audited entity in understanding the methods, models, assumptions, and inputs that were used in calculating a given sum. All of which, except where it is reasonable to state that the results of said services will not be subjected to audit procedures during the audit of the audited entity's financial statements.
- (11) Managerial positions. Temporary or permanent activity in the post of director, manager, or employee of the audited entity, or in the making of supervisory decisions, or regular participation in supervision of operations of the audited entity.
- (12) Human-resources management for the audited entity, including:
- (a) Searching for candidates for managerial or director positions;
 - (b) Involvement in psychological or other evaluative testing;
 - (c) Checking of references of candidates for management posts;

- (d) Negotiating on behalf of the audited entity in matters related to employees' terms of employment;
 - (e) Recommendation or consultation in regard to hiring a specific candidate for a specific post. The external auditor may, at the request of the audited banking corporation, interview candidates and advise the audited entity as to the suitability of a candidate for a post related to financial accounting, managerial duties, or control.
- (13) Provision of expert services for the audited entity that are unrelated to the audit. Furnishing the audited entity with an expert opinion, other expert services, or legal advocacy for the purpose of representing the audited entity's interests in legal, regulatory, or administrative proceedings, with the exception of advocacy on behalf of the audited entity vis-à-vis tax authorities. The independence of the external auditor shall not be impaired if, in the course of a legal, regulatory, or administrative proceeding, he is required to present facts, including testimony, about his work as the external auditor or to explain his views or conclusions as adopted during the provision of service for the audited entity.
- (14) Provision of auditing services without appropriate pay.
- (15) Any other activity that the Supervisor of Banks shall specify.

Circumstances Requiring Disclosure

4. An external auditor shall advise the audited banking corporation of his total income from other activities for the client, if it exceeds 10 percent of his total consolidated income from the same client. The provisions of this section shall not apply to a subsidiary of a banking group.

Misconduct

5. An action by an external auditor of a banking corporation that contravenes these provisions constitutes misconduct in respect to the independence that the external auditor of a banking corporation must maintain in his professional work.

Upholding of Provisions

6. These provisions in regard to the external auditor of a banking corporation are meant to augment any law and any directives issued or determined in accordance therewith, including the Certified Public Accountants (Conflict of Interests and Impairment of Independence Due to Other Activity) (Interim Provision) Regulations, 5763-2003, the decision of the Securities Authority of August 1992 concerning the independence of auditors, and guidelines issued by the Securities Authority under said decision.

Review of Interim Reports

7. The instructions in these provisions in regard to the performance of an audit shall also apply to the review of interim reports by the external auditor.
8. Null.

Incidence and Force

9. These provisions shall apply to any audit for auditing periods beginning on January 1, 2003.

Preruling

10. To avoid a situation whereby an audited entity becomes aware only upon the presentation of its financial statements that the statements do not qualify as duly audited statements due to lack of independence of the external auditor, the Supervisor of Banks is willing to issue a preruling concerning the external auditor's compliance with the requirements of independence. Said decision shall be handed down pursuant to an application to the Supervisor of Banks, in which all facts relating to the matter are presented.

Grandfathering

11. The independence of an external auditor vis-à-vis the audited entity shall not be regarded as impaired in the following cases:
 - (1) The external auditor received a loan or made a deposit with a client that is a banking corporation, under market conditions and in the ordinary course of the client's business, where all the following conditions are present:

- (a) Said economic relations are not prohibited under any other law;
 - (b) The transaction contract was signed before the issue of these provisions or said economic relationship was created by means of inheritance;
 - (c) The transaction contract was not amended in any material way after these provisions were gazetted or after the inheritance was received.
- (2) The external auditor engaged in one of the other activities listed in Sections 3.(3)(f), 3.(5), or 3.(7)–(14), during the first auditing period in which these provisions applied or during the preceding year, and where all of the following conditions were present:
- (a) Said activities are not prohibited under any other law;
 - (b) The transaction contract was signed before the issue of these provisions;
 - (c) The transaction contract was not amended in any material way after these provisions were gazetted.
- (3) The auditors' opinion was reissued after the external auditor ceased to serve in this capacity.

Appendix B

(Section 36 (a))

Ruling of the Securities Authority, August 1992

Independence of External Auditor

The ruling reached by the Securities Authority, and which it decided to publish in accordance with section 9b of the Securities Law, 5728–1968, is as follows:

A. General

1. The Securities Authority has recently been asked to deal with a number of cases involving the question of the professional independence of external auditors who audit the financial statements of companies to which the Securities Law, 5728–1968 (henceforth, the Securities Law) applies.
2. (a) Regulation 9(a) of the Securities Regulations (periodic and immediate reports), 5730–1970, states that the annual financial statements included in the periodic report that is submitted to the Authority and to other entities in accordance with section 36 of the Securities Law shall be "properly audited".
(b) Regulation no. 56(a) of the Securities Regulations (details, structure, and form of a prospectus), 5729–1969, states that the prospectus shall include the "properly audited" annual financial statements of the issuer.
3. The Accountancy Regulations (accountant's method of operation), 5733–1973, set regulations in the subject of auditing, including the independence required of an external auditor. Regulation no. 2(a) of these regulations states that "an accountant shall be independent of the party audited, whether directly or indirectly, and will remain independent in his professional work."

4. Unfortunately, the legislator has not elucidated, except for a few instances, what constitutes independence. Thus, Regulation no. 2(b) of the Accountancy Regulations (accountant's method of operation), 5733–1973 states, while noting that the provisions of that regulation supplement those of no. 2(a), that an accountant should not express an opinion with regard to the financial statement of an audited body, if the accountant is the clerk of that audited body, clerk of a parent company, of a subsidiary or of an affiliated company of the audited body, or a clerk of a party at interest of the audited body. Section no. 219 of the Companies Ordinance (new version), 5743–1983 states that neither an office-holder in a company, a partner of an office-holder in a public company, nor a person who is employed by an office-holder in a public company is eligible to be appointed as accountants.

The Institute of Certified Public Accountants in Israel has addressed the subject, and in July 1989 even published "Guidelines concerning the independence of an accountant". However, the Institute itself noted that these guidelines were "for purposes of clarification and do not claim to be a binding reinterpretation of any law, regulation, standard, or rule".

Under these circumstances, and particularly since the Authority is of the opinion that some of the guidelines published by the Institute do not meet the requirements, the Authority has decided to draw up and publish its position on this subject, clarifying what it regards as constituting the independence required of an accountant who audits the financial statements of a company to which the Securities Law applies, so that it will be possible to put into practice the demand that auditors of the financial statements submitted to the Authority be independent.

5. Nobody disputes the importance of auditing as the primary tool for imparting credibility to the financial information brought before the public by means of financial statements. This credibility is a cornerstone of the proper functioning of the capital market, and any impairment of it undermines public confidence in this market and its readiness to invest in it. The auditor's independence is the *sine qua non* of all this, and for the same reason it is not enough that it exist, but it must also be seen to exist. In other words, an auditor

must not only be independent, but must also be perceived as such by an outside observer.

6. It is the opinion of the Authority, that the required independence of the auditor does not exist whenever an auditor is deprived, whether actually or ostensibly, of the objectivity, independence, and ability to undertake an audit in an unprejudiced fashion or as he thinks best.
7. As the authorized body to which the aforesaid statements are submitted, the Securities Authority hereby clarify that financial statements audited by an external auditor in which the independence required under the regulations has not been maintained, do not constitute properly audited financial statements, and consequently it cannot regard such statements as meeting the requirements of the Securities Law and the regulations introduced accordingly.

B. Terms

In this ruling the meaning of the following terms shall be as follows:

- "Audit"** - As defined in the Accountants Regulation (accountant's method of operation), 5733–1973.
- "Auditor"** - The firm that undertakes the audit of the audited body, any partner or member of it, and any person who is actually involved in the audit of the audited body, as well as a corporation controlled by any of them or a trustee for the benefit of any of them.
- "Audited body"** - The corporation being audited.
- "Firm"** - An accountant, accountancy partnership, accountancy company, or any other association of accountants.

"Office-holder"- As defined in the Companies Ordinance (new version), 5743–1983, a corporation controlled by it or a trustee for its benefit.

"Holding" - As defined in the Securities Law, except for a blind trust.

"Relative of a person" -Someone who lives with the person, is supported by that person, supports that person, or a corporation controlled by any of them or a trustee for the benefit of any of them.

"Family member" - Spouse, son, grandchild, brother, parent, grandparent, spouse of any of them, parent of said spouse, or a corporation controlled by any of these, or a trustee for the benefit of any of them.

Any other term, which is not specifically defined in this ruling, shall be as defined in the Securities Law.

C. Situations in which the independence required of the auditor is not upheld

By its nature, the existence of independence depends on the circumstances of each case, and it is impossible to describe and define all the possible situations in which the independence required of the auditor does not exist. Below is a list of typical situations where independence is not upheld. Nevertheless, it is obvious that there are additional situations, not described here, in which the auditor is not independent, as required. The parties determination in the independence situations that follow are deliberately described in a restricted way, so as not to attach undue importance to circumstances in which in most cases independence is not seriously impaired. Nonetheless, it is obvious that even in circumstances that are extremely unlike the situations described below, there will be situations where independence will not be upheld. For example, a person whose family ties with the auditor do not resemble the cases described here, but has very substantial business ties with the audited body.

The Authority shall decide in any case which is not included in the situations specified in this ruling, in accordance with the circumstances, taking into account the size of the firm

and of the audited body, closeness of the ties to the auditor or the audited body, nature of the ties, etc. The same will apply to the rare cases, if there will be any, which are included in the situations specified but in which independence, whether actual or ostensible, is maintained.

For the sake of clarity, it is stressed hereby that the division and classification of subjects and sections in the list that follows are solely for the purpose of convenience.

1. **Economic ties between the auditor and the audited body**

Economic ties between the auditor and the audited body could lead to a situation in which the auditor has an interest in the audited body's business situation or in the results of his activities. Ties of this kind could also place the auditor in a situation of conflict of interests. Either way, the independence required of the auditor is not maintained, whether actually or ostensibly.

Below are a few instances of situations of this kind:

- 1.1 1.1.1 The auditor or his relative holds securities of the audited body, a parent company, a subsidiary or an affiliated company of his.
In this section, "**the auditor**" - includes a senior employee in it.
- 1.1.2 A family member of the auditor holds securities of the audited body, of a parent company or a subsidiary of his, and the holding is significant for the holder or a significant share in the undertaking.
- 1.2 1.2.1 The auditor is an employee or office-holder of the audited body, a parent company or a subsidiary of his, or an office-holder or party at interest in the audited body, or is a partner of an office-holder in the audited body.
- 1.2.2. A relative of the auditor is an office-holder in the audited body, a parent company or a subsidiary of his.
- 1.2.3. A relative of the auditor is a senior employee in the audited body, a parent company or a subsidiary of his.

1.3 The auditor was an employee or office-holder in the audited body, in a subsidiary of his which he is auditing, or in an affiliated company of his which he is auditing, and two years have not yet passed since he stopped being an employee or office-holder as aforesaid.

In this subsection, "**The Auditor**" - Any person who is actually involved in the audit of the audited body

1.4 1.4.1 The auditor or his relative has business ties (supplier-customer, service provider-service receiver, leasing of assets, business partnerships, joint ventures, partnership in assets, etc.) with the audited body, a parent company or a subsidiary of his, except if this is a routine transaction of buying and selling a product or service, involving an amount which is not material, during the course of regular business dealings, at a price and conditions that would be granted to a similar customer.

1.4.2. The auditor or his relative has business ties, which are material for one of the parties, with a controlling interest in the audited body, an office-holder in the audited body, or an office-holder in a subsidiary of the audited body.

1.5 Professional responsibility insurance of the auditor by the audited body, a parent company, a subsidiary of the parent company, or a subsidiary of the audited body.

1.6 1.6.1 Granting a loan or guarantee to the auditor or a relative of his by the audited body, a subsidiary of his, an office-holder in one of them, a parent company of the audited body, an affiliated company of his, or a party at interest in him. The provisions of this section shall not apply to someone who does not actually engage in auditing the audited body, and to a relative of his, provided that this is the

occupation of the person granting the loan or the guarantee, and the loan or the guarantee would be given to a similar customer and was granted in similar circumstances to those that would be given to a similar customer; this applies to the amount of the loan, interest, fees, term of loan, repayment arrangement, collateral, etc.

- 1.6.2 Granting a loan or guarantee by the auditor or a relative of his to the audited body, to a parent company, subsidiary, or affiliated company of his, to an office-holder in any one of them, or to a party at interest in the audited body.

2. **Payment for the audit**

By its very nature, the arrangement whereby the audited body pays the auditor for the audit, creates a situation of dependence. Nonetheless, because of the lack of a reasonable alternative for such payment, this arrangement is acceptable, provided the impairment of independence does not go beyond the necessary minimum arising from the nature of the arrangement.

Below are a several situations in which the auditor is not independent:

- 2.1 The rate of payment has not been set in advance.
- 2.2 The rate of payment is conditional or in kind.
- 2.3 The payment exceeds what was agreed in advance, and not as a result of expanding the audit.
- 2.4 The payment or part of it is paid by a person, other than the audited body, who may have an interest in the results of the audit.
- 2.5 There is an outstanding debt for auditing or some other service.

3. **Extent of income**

- 3.1 The auditor's total income from the audited body or from a group of audited bodies connected with the audited body in the previous accounting year, exceeded 15% of the firm's income in that accounting year.

In this subsection "**connected audited bodies**" – a parent company of the audited body, a subsidiary his or another company that is controlled by someone who, either directly or via relatives, controls the audited body, as well as an office-holder in them.

This subsection shall not apply to a firm in the first three years of its existence, provided the extent of the aforesaid income does not exceed 25%; the foregoing does not apply to the restructuring of existing firms.

- 3.2 The auditor's income in the previous accounting year from payment for auditing the audited body was less than half his total income from the same audited body in that accounting year.

In this subsection, "**audit**" - including review of interim financial statements.

- 3.3 In calculating the auditor's income for the purposes of this section, income from dealing with the audited body's prospectus or other income of a special or non-recurring nature shall not be taken into consideration.

4. **Related services**

Extending related services to an audited body by an auditor could impair the independence required of the auditor, either because business-economic dependence will develop or because a conflict of interests will arise between the related services extended by the auditor and his role as auditor.

Below are a few instances of situations of this kind:

- 4.1 Extension of related services to an audited body by the auditor, which actually or ostensibly deviate from giving advice and in effect constitute participation in management and decision-making of the audited body.
- 4.2 Extension of related services, which by their nature could be audited by the auditor (e.g., serving as the audited body's bookkeeper).
- 4.3 The auditor serves as the audited body's internal auditor.

5. Other conflicts of interest

There are other situations in which there is a conflict of interest between the function of the accountant as auditor and his other positions, occupations, and activities, as a result of which his independence is impaired.

Below are a few instances of situations of this kind:

- 5.1 5.1.1 The auditor or a relative of his is the receiver, appointed manager, manager prior to temporary liquidation, liquidator, or other similar function of the audited body, a parent-company or a subsidiary, or of a company which has significant business ties with the audited body, or acts on behalf of any one of them.
- 5.1.2. The auditor or a relative of his is the receiver, temporary receiver, or trustee of the holdings of a party at interest in the audited body or acts on behalf of any one of them.
- 5.2 The auditor or a relative of his manages the estate of a party at interest in the audited body or acts on behalf of the manager of the estate.
- 5.3 There is a significant business competition between the auditor or a relative of his and the audited body, a parent-company or a subsidiary of his, person with a controlling interest in him or a relative of such a person.
- 5.4 There is an unresolved legal dispute, including arbitration, between the auditor or a relative of his and the audited body, a parent-company or a subsidiary of his, or person with a controlling interest in him.
- 5.5 The auditor or a relative of his is a party at interest in a person who is an underwriter of an issue of the audited body, or of a parent-company or subsidiary of his.
- 5.6 The auditor or a relative of his is a controlling party in a trustee of the securities of the audited body, a parent-company, or subsidiary of his.
- 5.7 There is an arrangement for the indemnification or insurance of the auditor by the audited body or a person appointed by him, for a charge resulting from the auditor's professional responsibility for the audit.

6. Family ties

ONLY THE HEBREW VERSION IS BINDING

- 6.1 The auditor is related to or a family member of an office-holder in the audited body.
- 6.2 The auditor is related to or a family member of a person who directly controls data or activities which could have a significant effect on the audited body's financial statements.

In this subsection, “**the Auditor**” - anyone dealing in effect with the audit of the audited body.

D. Additional provisions

1. Date at which independence is required

The existence of independence is required throughout the audit period and until the date the audit opinion is submitted, except for when a second opinion is rendered on financial statements that are included in a prospectus that is based on a previous opinion of the same auditor, or if, at the time the second opinion is rendered, he no longer serves as the auditor.

For the period referring to the annual financial statements that are included in the prospectus of a company that is making an IPO, except for those of the last accounting year that are included in the prospectus, the Authority shall examine the question whether independence was upheld in accordance with the substance of the matter, taking into account the fact that the company was a private company at the time.

2. Application

2.1 This ruling shall be applied:

- (a) With regard to annual financial statements that are included in a periodic report to be submitted starting January 1st, 1993.

(b) With regard to annual financial statements that are included in a prospectus, starting with the annual financial statements for the 1992 accounting year.

2.2 Despite the aforementioned in subsection 2.1 above, the provision in subsection 3.1 in Chapter C shall be applied to annual financial statements that are included in a periodic report to be submitted starting January 1st, 1994 and to the financial statements included in the prospectus, starting with the annual financial statements for the 1993 accounting year.

3. **Transitional provisions**

3.1 In cases where the ties or associations causing independence to be impaired were created before the publication of this ruling, the dates set down in subsection 2.1 of this chapter shall be January 1st, 1994 and the 1993 accounting year respectively.

3.2 If ties of the kinds included in subsections 1.2.3, 1.4, and 1.6 in Chapter C were created before the publication of this ruling and at a time in accordance with the contents of subsection 3.1 above, and have not yet been untied in accordance with the timetable originally determined, in special instances the Authority will consider extending the said dates for a predetermined period. A ruling in this respect will be given on the basis of a request submitted to the Authority and containing all the pertinent facts.

3.3 Despite the aforesaid in subsections 3.1 and 3.2 above, if the Authority finds that the circumstances for the lack of independence in a certain case require this, it will apply the dates specified in subsection 2.1 of this chapter.

3.4 With regard to lack of independence that has been amended before the publication of this ruling, or close to it, the period of lack of independence will not be taken into account.

4. **Preruling**

In order to avoid a situation in which a company is informed only when its financial statements are submitted that because the auditor's lack of independence the statements are not properly audited, the Authority is prepared to give a preruling as regards the auditor's independence.

A ruling of this kind will be given if a request containing all the relevant facts is submitted to the Authority.

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