

**Draft Minutes of the Meeting of the  
International Ethics Standards Board for Accountants  
February 6-8, 2011  
New Delhi, India**

	<b>Members</b>	<b>Technical Advisors</b>
<i>Present:</i>	Ken Dakdduk	Lisa Snyder
	Robert Franchini	Sylvie Soulier
	James Gaa	Stephen Spector
	Jörgen Holmquist	
	Peter Hughes	
	Felicitas Irungu	
	Wui San Kwok	Andrew Pinkney
	Alice McCleary	
	Michael Niehues	Petra Gunia
	Marisa Orbea	Liesbet Haustermans
	Robert Rutherford	
	Isabelle Sapet	Jean-Luc Doyle
	Kate Spargo	
	Don Thomson	Kim Gibson
	Sandrine Van Bellinghen	Christine Cloquet
	Brian Walsh	Tony Bromell
<i>Regrets</i>	Nina Barakzai	
	Caroline Gardner	

**Non-Voting Observers**

<i>Present:</i>	Richard Fleck
	Koichiro Kuramochi
<i>Regrets</i>	Juan Maria Arteagoitia

**PIOB**

<i>Present</i>	Toshiharu Kitamura
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**IFAC Technical Staff**

<i>Present:</i>	Jan Munro
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## **Guests**

Jason Evans (AICPA staff)

### **1. Introduction and Administrative Matters**

Mr. Dakdduk opened the meeting and welcomed participants. He thanked The Institute of Chartered Accountants of India (ICAI) for hosting the meeting and invited Mr. Jaydeep N. Shah, Chairman of the Ethical Standards Board of the ICAI, to make some remarks.

Mr. Shah welcomed the IESBA members and other participants to New Delhi. He provided an overview of the membership of the ICAI, its interactions with IFAC, and the status of the adoption of the IESBA Code in India. Mr. Dakdduk thanked Mr. Shah for his remarks.

Mr. Dakdduk welcomed new IESBA members Mr. Holmquist, a public member nominated by the Nordic Federation of Public Accountants, and Ms. Irungu, nominated by the Institute of Certified Public Accountants of Kenya. He noted that apologies had been received from Mr. Arteagoitia, Ms. Barakzai, and Ms. Gardner.

Mr. Dakdduk welcomed Dr. Kitamura observing the meeting on behalf of the Public Interest Oversight Board (PIOB).

#### *Minutes of the Previous Meeting*

The minutes of the November 2010 IESBA meeting were approved as presented.

#### *Outreach Activities Conducted Concurrent with the Singapore Meeting*

Mr. Dakdduk reported on the outreach activities conducted by IESBA members shortly before and after the November 2010 meeting in Singapore. Activities included:

- Singapore Accountancy Association Convention, Singapore – Mr. Walsh;
- Accounting and Corporate Regulatory Authority, Singapore – Mr. Dakdduk, Mr. Kwok, and Ms. Munro; and
- World Congress of Accountants, Kuala Lumpur, Malaysia – Mr. Dakdduk, Ms. McCleary, Mr. Niehues, and Ms. Aiko Sekine (whose term as a board member expired at the end of 2010).

#### *Green Paper*

Mr. Dakdduk reported that the IESBA response to the EU Green Paper had been submitted by the comment deadline and a copy had been circulated to all IESBA members. Mr. Dakdduk thanked Ms. Sapet for developing the response letter and all IESBA members who had provided comments on drafts of the letter. He noted that he understood several hundred letters had been submitted. The EU recently issued a 36 page

summary of the responses which he, Ms. Sapet, and Mr. Niehues would review and report on later in the meeting.

### *Convergence*

Mr. Pinkney provided a status report on the benchmarking and data gathering exercise being undertaken by some Board members and technical advisors. The objective is to compare the key independence provisions in the Code for the audit of public interest entities to the standards and regulations of select jurisdictions applicable to statutory audits or equivalent, and prepare an analysis of key differences for the IESBA's consideration. Accordingly, the comparison will focus on (a) the prohibitions and (b) those circumstances that are permitted only if certain conditions exist or specified safeguards are applied. It will also cover the Code's overarching principles and key terms.

The initial comparison, using a template, will be prepared for nine countries, which have nine of the 15 largest stock markets (US (SEC/PCAOB), France, Germany, Australia, UK (APB), Brazil, Japan, Hong Kong, and Canada). After consideration of the initial findings, the IESBA may decide to extend the exercise to other jurisdictions. To date initial comparisons have been received for six of the nine jurisdictions and work continues on the others. Mr. Pinkney noted that a schedule of differences (identifying where the regulations are substantively more restrictive) will be presented for the IESBA's consideration at its June 2011 meeting. Mr. Dakdduk thanked Mr. Pinkney for leading this initiative and all those who are assisting in developing the comparison to advise and support the IESBA in its convergence initiative.

### *Responding to Suspected Fraud and Illegal Acts*

This Task Force, chaired by Mr. Franchini, with Ms. Gardner, Ms. Sapet, Ms. Sekine (until December 31, 2010), Ms. Spargo, and Mr. Walsh as members, has met twice since the November IESBA meeting. The topic would be addressed under Agenda Item 5.

### *Conflicts of Interest*

This Task Force, chaired by Mr. Niehues, with Ms. Barakzai, Mr. Gaa, Mr. Hughes, Ms. Soulier, Mr. Rutherford, and Ms. Van Bellinghen as members, has met twice since the November IESBA meeting. The topic would be addressed under Agenda Item 6.

### *Inadvertent Violation*

This Task Force, chaired by Ms. Spargo, with Mr. Kwok, Ms. McCleary, and Ms. Orbea as members, has met twice since the November IESBA meeting. The topic would be addressed under Agenda Item 8.

### *Planning Committee*

The Planning Committee, chaired by Mr. Dakdduk, with Mr. Fleck, Mr. Franchini, Mr. Niehues, Ms. Sapet, Mr. Volker Röhrich (until December 31, 2010), and Mr. Walsh as members, has met once since the November IESBA meeting. The Planning Committee discussed research studies and other thought leadership activities of various

organizations, such as FEE's Discussion Paper on Integrity, and agreed that it would be useful to develop a process to make stakeholders aware of such papers.

*International Organization of Securities Commissions (IOSCO)*

Mr. Dakdduk reported that he and Ms. Spargo met with IOSCO's Auditing Subcommittee by conference call to discuss the inadvertent violations project.

*Other Outreach*

Mr. Dakdduk reported on the outreach activities conducted by IESBA members since the November IESBA meeting. Activities included:

- Crowe Horwath International, November 2010, New York, United States, Mr. Hughes;
- PKF International Annual Conference, November 2010, Prague, Czech Republic, Mr. Niehues;
- FEE Council Meeting, December 2010, Brussels, Belgium, Mr. Dakdduk.

## **2. Monitoring Group Report**

Mr. Dakdduk introduced the topic. He noted that the purpose of the agenda item is to provide the IESBA with the opportunity to consider the recommendations of the Monitoring Group that directly impact the IESBA and IFAC's tentative responses to those recommendations. IESBA members' views on the recommendations and IFAC's preliminary responses would be provided to IFAC leadership for their consideration.

The purpose of the Monitoring Group review was to fulfill the 2003 IFAC reforms, which called for a five-year review of the implementation of the reforms. The provisions of the reforms, as described in the Monitoring Group Report, described changes to the structure and processes of the standard-setting boards and committees within IFAC that develop standards for auditing, auditor independence, accountant education, and so forth. The objective of the reforms was to increase confidence that these activities were properly responsive to the public interest and would lead to the establishment of both high quality standards and practices in auditing and assurance.

The first Monitoring Group recommendation is that IFAC should change the practice of reserving 15 out of the 18 seats on the Audit Board and Ethics Board for nominees of the Forum of Firms and IFAC member bodies so that the opportunity for a Board member appointment is more easily accessible to all qualified persons. The tentative IFAC response is to seek to understand better the concerns that led to the recommendation and through discussion look for a solution that can address the concerns in an appropriate and proportionate manner. A change to remove the reserved positions would require a change to the IFAC and Forum of Firms' Constitutions.

The IESBA discussed the recommendation and the following points were noted:

- A practitioner is defined as a member or an employee of an audit firm. A non-practitioner is defined as someone who is not a member or employee of an audit firm. While the definition of non-practitioner might be appropriate and relevant

- for the International Audit and Assurance Standards Board (IAASB), the remit of the IESBA is broader than that of the IAASB and, therefore, perhaps the definition of non-practitioner for the IESBA should reflect its broader remit. That is, the Code applies to all professional accountants, not just accountants who are auditors. The definition of non-practitioner might therefore reflect this in a more specific manner than simply referring to anyone who is not with an audit firm.
- If the development of ethics standards is to be subject to robust and transparent debate, it is important to have members of the profession at the table. Perhaps having 15 possible members out of 18 is not necessary, but it is important that there is sufficient representation.
  - It is important to have participation from those who would have to implement revisions to the Code. Without such participation, the IESBA could find out late in the process or may be unaware of possible unintended consequences of a recommendation.
  - A possible driver for the recommendation could be that some Monitoring Group members were of the view that the IESBA has not adequately addressed regulator concerns. For example, IOSCO commented on the inadvertent violation provisions of the Code in responding to a July 2008 exposure draft proposing new drafting conventions. Recognizing that a project on inadvertent violations could not be addressed in a project on drafting conventions, the IESBA completed its drafting conventions project first. It has now commenced a project to review the inadvertent violation provisions in the Code, but it is two years after the comment was received.
  - The recommendations address the issue of perception and perhaps part of the response should be educational. For example, the remarks made at the November 2011 IESBA meeting by outgoing public member Volker Röhricht were very insightful and informative and careful consideration should be given to how those remarks could be disseminated.
  - The public members are in the minority on the IESBA. In the field of corporate governance, the proportion (one sixth of total members) would be seen as very low.
  - Consideration should be given to having a greater proportion of members representing those who “consume” the services provided by accountants, such as audit committee members.

The second Monitoring Group recommendation is that IFAC should evaluate the current time and financial commitments asked of Board members in relation to whether such commitments are feasible for a large enough and diverse enough pool of qualified non-practitioners who could realistically serve on the Boards. The tentative IFAC response to the recommendation is similar to the response to the first recommendation to understand better the concerns that lead to the recommendation.

The third Monitoring Group recommendation is that IFAC should take a first step toward providing more independence to the work of the Ethics Board by providing it with an independent Chair position in view of the inherent conflicts of interest that particularly relate to the work of this Board. The tentative IFAC response recognizes the importance

of the independence of the process as a whole, and sees the independence of the chair as one element in the whole process. While IFAC believes the safeguards that are already applied to the threat of an inherent conflict of interests in the role of Chair of the IESBA are sufficient to neutralize the threat, IFAC wishes to discuss the nature and time frame of actions that might be taken to further mitigate the risk associated with the role of the Chair. In this context it would be helpful to have a discussion with the Monitoring Group to agree on the characteristics that would make for an independent chair. This would be particularly useful given that the role of the IESBA is much broader than addressing auditor independence. It would be helpful to have some elaboration of the criteria that the Monitoring Group would consider necessary to achieve independence. Appointing an independent Chair would require a change in the IFAC Constitution that would be placed before members in November 2011.

Mr. Dakdduk indicated it was his understanding that the recommendation is intended to deal with both actual and perceived conflicts of interest. He stated that while he did not have any actual conflict of interest, he did recognize the importance of perception and noted that the Code itself recognizes the importance of appearance and perception. He indicated that installing a chair who is independent of the profession would seem important if the IESBA is to successfully pursue its convergence objective. Accordingly, as soon as IFAC finds a chair that would be seen as suitable by all parties, it was his intention to step down as chair. In this regard he did not believe that he would serve out his full term.

The IESBA discussed the recommendation and the following points were noted:

- The recommendation might indicate that greater transparency is needed on how the IESBA chair is selected;
- If the time commitment of 50-60% is appropriate, this would indicate that the position would need to be remunerated, which raises the question of how the position would be funded;
- While the issue of perception is important, it is also very important that there be an appropriate transition to the new chair;
- It would be interesting to understand more fully the Monitoring Group's views as to the criteria that would need to be satisfied for the Chair to be considered independent; and
- While the issue of perception is important, this should be balanced against the fact that all the IESBA meetings are public and there is appropriate due process and effective oversight.
- The important criterion is the integrity of the person who serves as IESBA chair, such that people have confidence that the individual will not bow to pressure. The person's employment is of a secondary matter.

The fourth Monitoring Group recommendation is that IFAC should manage the Board member appointments such that a substantial number of the non-practitioners who serve on the boards work outside of auditing-related organizations, including auditor professional associations, so that they bring other perspectives to the debates. The tentative IFAC response is that the current nominations process, with oversight by the

PIOB, has already sought to balance the perspectives of voting members around the board tables. IFAC welcomes discussion aimed at reaching a mutually acceptable definition of non-practitioner.

The fifth Monitoring Group recommendation is that IFAC should make complete information about the backgrounds, qualifications, and affiliations of board members available on its website so that from this perspective regulators and external stakeholders could better decide the level of confidence they wish to place in the boards' work. The tentative IFAC response is that IFAC will develop a template to provide more relevant information about backgrounds, qualifications, and affiliations of board members and their technical advisors.

The IESBA discussed the recommendation and the following points were noted:

- If there was concern with the membership of the boards, it was difficult to see how greater transparency regarding backgrounds, qualifications, and affiliations of board members would address that concern. The matter would need to be addressed in the appointment process;
- While there is an appointment process for the members, there is no such process for technical advisors; and
- There did not seem to be a significant distinction between someone who was currently working as an accountant and someone who had been trained as an accountant. The training that an individual undertakes will shape how they consider and approach issues.

The sixth Monitoring Group recommendation is that the board Chairs should ensure that the involvement of technical advisors in the boards' work encompasses only advisory and support roles so that the technical advisors are not effectively carrying out the boards' work via their level of involvement in the boards' evaluation and decision making processes. The tentative IFAC response is that the board Chairs confirm this is already done and have reminded the technical advisors of their role in previous board meetings. A view was expressed that perhaps this recommendation was more reflective of past practice.

The seventh Monitoring Group recommendation is that if the roles of technical advisors are significant in task forces or other board-related work, then IFAC should make backgrounds and the nature and degree of the rights and responsibilities of technical advisors available on its website to provide transparency. The tentative IFAC response is to agree with this recommendation and proceed in the same manner as outlined in the response to the fifth recommendation.

The eighth Monitoring Group recommendation is that the boards should develop processes or practices for identifying the issues raised by those who represent the public interest so that those issues can receive adequate attention in board papers and board discussions. The tentative IFAC response is that this is already part of the current process and that many respondents raise issues that specifically address the public interest regardless of whether they might be perceived as representing a specific constituency.

The fact that the respondent is not a regulatory authority does not negate the fact that their response may have genuine public interest issues to consider. The IFAC public policy draft document currently exposed for comment proposes that the public interest is met when all constituencies have a chance to comment.

The IESBA discussed the recommendation and the following points were noted:

- More dialogue with the Monitoring Group would be helpful to obtain a better understanding of who would be seen as representing the public interest;
- Similar to the first recommendation, one of the drivers for this recommendation could be that IOSCO is of the view that IESBA has not been responsive enough to issues it has raised;
- The IESBA considers all responses based on merit and there have been instances where the IESBA has changed a position because of views expressed by a minority of respondents because of the persuasiveness of the arguments presented and their public interest role;
- A public member expressed the view that public interest matters are carefully and fully considered by the IESBA; and
- It might be useful to formalize some of the outreach that is being conducted to try and obtain more public interest input earlier in a project's development.

The ninth Monitoring Group recommendation is that the boards should either discontinue proxy voting or limit it to truly exceptional cases so that board members themselves carry out the voting aspect of the board's deliberative work. The tentative IFAC response is that the IFAC Board will be asked to review this recommendation and if the Board agrees (and subject to PIOB approval), the terms of reference will be amended to make this specific. It is possible that the current practice followed by all PIAC Chairs of requiring the members to give their proxy to another member representing the same group of members (non-practitioner, public member, etc.) will suffice but should be specified in the terms of reference. This can be coupled with a provision for proxies in exceptional circumstances, which may be better left undefined

The tenth Monitoring Group recommendation is that the boards' procedures should ensure identification of the views of all stakeholder groups, with emphasis on the quality and public interest rationale of the points raised rather than on the number of responders. The tentative IFAC response is that the Chairs believe this is already being done. IFAC considers that the processes of the PIACs are already designed to focus on the quality of arguments and the nature of the respondent, rather than the number of responses. IFAC would welcome suggestions from the Monitoring Group on ways to better demonstrate this.

The eleventh Monitoring Group recommendation is that as each project progresses the boards should provide a summary of tentative decisions to-date on the IFAC website so there is a better opportunity for constituents to notice any concerns along the way and then reach out to the boards in a timely fashion. The tentative IFAC response is that is already done and IFAC would welcome a dialogue to understand more clearly what the Monitoring Group is looking for in these new processes or practices.



The twelfth Monitoring Group recommendation is that IFAC, in consultation with the Monitoring Group members, should put in place the arrangements called for in the Reforms for the boards to provide direct feedback to an individual Monitoring Group member regarding its input to the boards if it does not appear that the boards will take up the input in a final Standard in the manner that the Monitoring Group member recommended. The tentative IFAC response is to agree with this recommendation and IFAC will work with the Monitoring Group to identify arrangements that might give effect to this recommendation, taking account the need to develop processes that are efficient and timely.

Mr. Dakdduk asked IESBA members whether they had any other comments on the recommendations. An IESBA member noted that many of the IFAC tentative responses referred to the need to obtain a better understanding of the Monitoring Group concerns that had led to the recommendation. The IESBA member asked whether there had been dialogue between IFAC and the Monitoring Group as the report had been developed. Mr. Dakdduk responded that such dialogue had taken place. In addition, he had met with the Monitoring Group as it was developing its report. He indicated that he felt that the IFAC tentative responses are aimed at ensuring that there is a full understanding of the issues that had led to the recommendation so that IFAC could develop an appropriate response.

Mr. Dakdduk thanked all IESBA members for their input and indicated that their comments would be passed on to IFAC leadership for their consideration.

### **3. Strategy and Work Plan 2010-2012**

Mr. Dakdduk introduced the topic. The IESBA Strategy and Work Plan for the period 2011-2012 was exposed in 2010 and, at its November 2010 meeting, the IESBA discussed the comments received on exposure and proposed changes to respond to those comments. The agenda paper referred to a revised draft of the plan, marked up to show the changes in response to the IESBA input at the November 2010 meeting. The draft had been circulated to IESBA members subsequent to the November meeting in preparation of a conference call, which would have taken place in December 2010. While it had not been possible to schedule a conference call, some IESBA members had provided some additional editorial changes and identified some typographical errors.

The IESBA discussed the Strategy and Work Plan and the following changes were agreed:

- The footnote referencing the Professional Accountancy Organization Development Committee should be corrected;
- The Chair's report contained the sentence "The IESBA will also explore other approaches to communicating with stakeholders on key issues, including developing a document or other form of communication that conveys the IESBA's views on matters and provides helpful guidance without amending the Code." This sentence should also be reflected in the Strategy itself.

An IESBA member asked whether there was an inconsistency in the way the convergence activity relating to comparison of key independence provisions was described. It was noted that in the body of the Strategy this activity refers to a comparison of all key provisions whereas in the appendix, the reference is to independence provisions related to public interest entities. The IESBA considered the issue but concluded that no change was necessary because the appendix contains a time line indicating that the comparison for public interest entities commenced in the first quarter of 2011. The body of the Strategy contains a description of the initiatives during the two-year period covered by the plan and it is possible that, having made progress on the comparison of the public interest entity provisions, the comparison would be expanded to the requirements that relate to other entities.

Dr. Kitamura asked a question regarding a statement in the November 2010 minutes in relation to a discussion in the strategy. He noted that the minutes stated:

“While the Code defines a public interest entity, it does not define SMEs. However, it would be incorrect to refer to SMEs as “not public interest entities” because there is a public interest element to professional accountants, whether in business or public practice, providing services to SMEs.”

He asked how this interacted with the statement in the Strategy that says "The working group will report its findings and recommendations to the IESBA. This recommendation will reflect the importance of professional accountants who are SMPs and SMEs serving the public interest . . ." Mr. Dakdduk responded that the statement in the Strategy is intended to reflect the fact that because a professional accountant has an obligation under the Code to act in the public interest, there is a public interest element in the responsibility of professional accountants working in SMEs or SMPs. The statement in the minutes reflects the fact that just because an entity is an SME doesn't necessarily mean it may not have a public interest element to it.

Subject to the changes noted above, the IESBA approved the Strategy and Work Plan 2011-2012 (sixteen affirmative votes).

#### **4. SME/SMP Working Group**

Mr. Thomson introduced the topic. He reported that the Working Group has been established and had its first meeting in January 2011. He provided information on the backgrounds of the Working Group members and noted that the Working Group supports the draft Terms of Reference. Mr. Thomson then asked the IESBA to approve the Terms of Reference. Before approving the Terms of Reference, the IESBA recommended adding the words "professional accountants in" immediately before "SMEs and SMPs" in the first line of the objective, and a clarification that the scope of the working group covers entities that are not public interest entities. The Terms of Reference will be revised to include a new sentence at the end of the objective paragraph stating “For this objective, SMEs do not include public interest entities.” The IESBA approved the Terms of Reference subject to these revisions.

Although the scope of the working group does not include public interest entities, Mr. Thomson noted that if issues are identified by the working group that impact public interest entities, he will inform the IESBA of those issues.

The IESBA discussed the status report and the following points were noted:

- It is important that the working group address relevant geographic and other perspectives that may not be represented by the current members. Dialogue with SMP Committee members and attendees at the SMP Forum will create an opportunity for insights into those perspectives. The Working Group will also consider reaching out in other ways, such as targeted inquiries to particular individuals or bodies; and it may be appropriate to identify and appoint another Working Group member.
- The Working Group is currently gathering information and validating any compliance issues that may prove to be challenging for professional accountants in SMEs and SMPs. After validation, the Working Group will provide its findings and recommendations to the IESBA, which may include suggested revisions to the Code, such as providing examples of appropriate safeguards for SMPs, including sole practitioners. Although the Working Group will be open to the possibility of a need to revise the Code, the Working Group's primary objective is to recommend ways that the IESBA could help professional accountants in SMEs and SMPs to comply with the Code, not to recommend changes to the Code that eliminate the need to comply with a provision. The Working Group will consider whether a particular issue and corresponding recommendation relates only to certain SMEs or SMPs, for example, those subject to resource constraints. SMPs vary considerably in size and resources, and this variation may be relevant when the Working Group is considering particular challenges.
- It might be useful for the Working Group to consider the following three areas when structuring discussion and recommendations:
  - a. Issues that may be faced by professional accountants in SMPs;
  - b. Issues that may be faced by professional accountants in SMEs;
  - c. Issues that may be faced by SMEs obtaining services from professional accountants in SMPs and other firms.
- The Working Group should consider if there are any issues for SMPs when performing non-assurance services for non-assurance clients and if the Code should provide additional guidance in this area.
- A potential project arising from the Working Group's efforts may be the development of a summary of the Code's requirements for performing non-assurance services for audit clients other than public interest entities, similar to the current IESBA's project on providing non-assurance services to public interest entity audit clients.

- SMEs continue to grow and SMPs are thinking of the challenges they may face in providing services to a larger and more complex client. The Working Group should consider whether the IESBA can help those SMPs comply with the Code while providing the services needed by their clients.

Mr. Thomson concluded the discussion by informing the IESBA of the Working Group's participation in the IFAC SMP Forum to be held in Istanbul on March 21, 2011. Mr. Thomson thanked the IESBA members for their input and will report back at the June meeting.

## **5. Responding to a Suspected Fraud or Illegal Act**

Mr. Franchini introduced the topic. He noted that at the November 2010 meeting, the IESBA approved a project proposal to address how a professional accountant should respond when encountering a suspected fraud or illegal act. The Task Force met twice since the November meeting and developed draft wording for a section to address professional accountants in public practice (new section 225) and professional accountants in business (new section 360).

Confidentiality is one of the fundamental principles in the Code. The principle requires the professional accountant:

“to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties.”

Section 140 identifies three circumstances where a professional accountant is required, or may be required, to disclose confidential information:

- Disclosure is permitted by law and is authorized by the client or the employer;
- Disclosure is required by law; and
- There is a professional duty or right to disclose when not prohibited by law.

While the Code recognizes that a professional accountant may have a professional duty or right to disclose confidential information, it does not provide examples or guidance on how to respond in such situations.

### *Nature of Items to be Addressed*

The Task Force considered the nature of the items to be addressed. The project proposal calls for the Task Force to be mindful of *ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* and *ISA 250, Consideration of Laws and Regulations in an Audit of Financial Statements*.

ISA 240 defines a fraud as “an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the

use of deception to obtain an unjust or illegal advantage.” The Task Force considered this definition and determined that it is an appropriate descriptor for the scope of the guidance to be developed. The IESBA agreed.

ISA 250 refers to non-compliance with laws and regulations. The ISA defines non-compliance as “Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or employees. Non-compliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management or employees of the entity.” The Task Force considered the ISA 250 definition and determined that it is an appropriate descriptor for the scope of the guidance to be developed. The IESBA agreed.

The Task Force felt that it was important that the project address suspected fraud and illegal acts that have a direct or indirect effect on the financial reporting of the client or employing entity. The Task Force felt that this was appropriate because an accountant’s expertise is linked to financial reporting.

The Task Force also considered whether the scope of the project should be wider and address, for example, personal misconduct and matters that are “unethical or improper.” The Task Force considered this matter and was of the view that the sections should address suspected frauds and illegal acts and should not be wider to address personal misconduct or matters that could be considered to be “unethical or improper.” Whether a matter would be considered to be “unethical” or “improper” is a subjective judgment. Given the significance of a requirement to breach confidentiality and disclose such a matter outside of the client or employing organization based on a subjective judgment, the Task Force believes that such a requirement could be excessively difficult to meet. In addition, paragraphs 210.1-210.5 and 300.15 of the Code already provide some guidance in this area.

The IESBA discussed the proposed exclusion of unethical or improper acts from a requirement to disclose outside of the client or employing organization. The following points were noted:

- While paragraph 300.15 explicitly refers to unethical behavior, paragraphs 210.1-210.5 do not. It would be useful if the Task Force considered this difference to determine whether it was appropriate;
- Unethical or improper behavior is a somewhat nebulous matter and difficult to define. What might be seen as ethical at the moment could later become unethical;
- While it might be difficult to define unethical behavior, the Code does currently use this term, which could indicate that an accountant would recognize an unethical matter when he or she encountered one. If, however, the Code had a requirement to disclose a matter outside of the client or employing organization, it would be important to clearly define the nature of the matter;

- If a matter is unethical or improper but not illegal, requiring an accountant to breach confidentiality and report the matter outside the client or employing organization would be an onerous requirement. It was noted that in financial reporting there can be deliberately “improper” application of accounting rules. In response, Mr. Franchini noted that such behavior should fall under the definition of fraud in ISA 240 and, accordingly, not require separate consideration; and
- It was not clear whether there needed to be a reference to both fraud and illegal acts because fraud is a subset of illegal acts – it might therefore be more appropriate to refer to either “fraud and other illegal acts” or merely refer to illegal acts. The split might also make it difficult to translate.

The IESBA discussed the proposal to focus on suspected frauds or illegal acts that have a direct or indirect effect on the financial reporting of the client or employing organization and the following points were noted:

- Restricting the scope in this manner might be too limiting. For example, in the case of an environmental illegal act, the key factor is the nature of the suspected environmental offense rather than the impact on the financial reporting;
- If the scope is limited to these matters, the accountant would be in the same position as the average person with respect to other matters. That is, matters that do not relate to financial reporting would not normally be within the competence of the accountant;
- An alternative argument was made that because of the wide range of activities undertaken by a professional accountant, the limitation would be inappropriate. For example, an accountant engaged to facilitate a strategic planning process may during the course of providing the professional service encounter a suspected illegal act. Under such circumstances it might be appropriate to disclose the matter outside the client;
- It was not clear whether such a limitation would meet the public interest test. The IESBA would need to be sure that stakeholders were comfortable with the scope and, if this approach was taken, the exposure draft should solicit specific input on the matter;
- The proposed drafting provides examples of frauds or illegal acts that might not have a direct or indirect effect on the financial statements, for example, insider trading and bribery;
- While it was appropriate to not include all illegal acts, the linkage to a direct or indirect effect on the financial reporting seemed to be subject to differing interpretations and it is important that there be clarity on what is addressed. One way to achieve this might be to link the matters to the professional expertise of the professional accountant or alternatively to the person who perpetrated the act;
- It might be helpful to explain that because of the need to act in the public interest, an professional accountant’s obligations, as they relate to illegal acts outside the expertise of a professional accountant, are over and above the obligations of a member of the general public. Accordingly, in such situations a professional accountant would be expected to act as a “good” citizen (rather than just an average citizen); and

- If the Task Force did retain the concepts of direct and indirect effect on the financial reporting, *ISA 250, Consideration of Laws and Regulations in an Audit of Financial Statements* contained some useful guidance on the matter.

It was noted that a discussion of the nature of items to be addressed can be more difficult if one pre-determines the actions to be taken. It would be preferable to first scope the nature of the matters to be addressed broadly. The next step would be to stratify the items with potentially differing courses of action depending upon the severity of the matter. The fact that the professional accountant suspects a matter is illegal or improper does not necessarily mean that the accountant should be required to report the matter.

#### *Process for Responding*

Mr. Franchini noted that in considering the thought process that the professional accountant would use in determining how to respond to a suspected fraud or illegal act, the Task Force developed a sequential approach for disclosing within the client or employing organization before considering whether the matter should be disclosed outside. Mr. Franchini described the sequential approach outlined in Agenda Paper 5. Whether the matter should be disclosed outside of the client or employing organization could be based on whether the matter has been satisfactorily addressed.

#### *Actions to be Taken after Disclosing within the Organization*

The Task Force considered what action, if any, the accountant should be required to take after the matter has been escalated within the client or employing organization. The Task Force considered two separate matters:

- Steps to be taken if the matter is not satisfactorily addressed; and
- Whether there should be an obligation/expectation/encouragement for the accountant to disclose the matter outside of the organization and, if so, under what conditions.

If a client or employing organization does not satisfactorily address a suspected fraud or illegal act – for example, if it does not take appropriate steps to prevent a recurrence of the matter — its integrity may be called into question. The guidance developed by the Task Force, therefore, requires that if, in the professional accountant's judgment, the matter has not been satisfactorily addressed, the accountant should determine an appropriate course of action – for example, whether to resign from the client or employing organization.

The determination of whether the matter has been satisfactorily addressed depends upon factors that include whether disclosure has been made to an appropriate authority. The Task Force has developed the following guidance on the factors that the accountant would consider to determine whether the matter has been satisfactorily addressed.

- Whether the matter was appropriately investigated;
- Whether appropriate available remedial action has been taken to address the matter;
- Whether steps have been taken to reduce the risk of recurrence, such as additional controls or training; and

- Whether the entity has disclosed the matter to an appropriate authority, or intends to do so within a reasonable period of time.

The Task Force is of the view that if the matter has not been disclosed to an appropriate authority by the entity, the professional accountant should determine whether such a disclosure would be in the public interest.

Mr. Franchini reported that in considering whether to disclose the matter outside the client or employing organization, if disclosure has not already been made, the Task Force considered the following possible levels of obligation for the professional accountant:

- The accountant shall determine whether to disclose;
  - The consequence of such a requirement would be that the accountant would need to be able to demonstrate that he or she had made the determination
- The accountant is encouraged or expected to disclose;
  - The consequence of such a requirement would be that the accountant would need to be able to demonstrate why the encouragement or expectation was not appropriate in the circumstances
- The accountant is required to disclose if disclosure is in the public interest, except when the nature of the outcome would be disproportionate to the matter (as might be the case when there was no authority to take action, or where disclosure carries the risk of physical harm);
  - The consequence of such a requirement would be that the accountant would need to be able to demonstrate why the outcome would be disproportionate; and
- The accountant is required to disclose if disclosure is in the public interest;
  - The consequence of such a requirement would be that the accountant would need to be able to demonstrate why disclosure was not in the public interest.

In determining the appropriate level of response, the Task Force considered that underpinning the Code is the fact that a distinguishing mark of the accountancy profession is its acceptance to act in the public interest. The Task Force also saw the need to balance the principle of confidentiality with the public interest.

The Task Force felt that (i) a determination of whether there was a need to report and (ii) the encouragement or expectation to report were too weak and not responsive to the public interest. With respect to the alternative of a requirement to report unless the outcome was disproportionate, the Task Force was concerned that it would not be possible to provide sufficient guidance on the meaning of disproportionate.

The Task Force recommendation, therefore, is that the appropriate threshold is a requirement to disclose if such disclosure would be in the public interest (the fourth option). Such a requirement is consistent with the underpinning of the Code of the profession's acceptance to act in the public interest.



Mr. Franchini reported that the Task Force had given a great deal of thought to what guidance could be given in the Code to help a professional accountant assess whether reporting would be in the public interest. The Task Force had not found a generally accepted definition of the public interest and therefore was of the view that the best approach is to provide an indication of the factors that would be considered in making this determination. The factors identified by the Task Force are:

- The significance to the entity's financial reporting;
- The extent to which external parties are likely to be affected; and
- The likelihood of recurrence.

Mr. Franchini indicated that it was not the intent of the Task Force that all of the factors would have to be satisfied for reporting to be in the public interest – for example, there may be a situation where the likelihood of recurrence was extremely low but reporting would still be in the public interest.

The Task Force recognizes that such a requirement may be particularly onerous for a professional accountant in business and, accordingly, recommends that a new obligation be included in the SMOs of member bodies to provide financial or legal support to those accountants that so require such support as a result of complying with this requirement.

In discussing the proposals, a question was raised as to whether the Task Force was aware of any studies documenting the nature and frequency of accountants reporting illegal acts to an appropriate authority. Mr. Franchini responded that the Task Force had not found any such studies and provided an overview of the legislation and guidance that had been reviewed by the Task Force and helped it to develop its thinking. It was noted that there may be lessons that could be learned from recent frauds or illegal acts.

The IESBA considered the Task Force's proposals and the following points were noted:

- In thinking about the requirement from the perspective of a professional accountant in public practice who was providing a non-assurance service to a non-assurance client, it might not be possible for the accountant to take reasonable steps to confirm or dispel the suspicion that an illegal act may have occurred. In such a situation, the accountant may not have access to either the appropriate level of management or those charged with governance. Mr. Franchini agreed that this was a possible scenario but indicated that if the accountant cannot take the reasonable steps because, for example, management is unwilling to discuss the matter, this could be an indication of management's lack of integrity. If this was the case, the accountant may be guided by the client acceptance guidance in section 210. It was noted that this might be the case in a recurring engagement but it might be more problematic in a one-off engagement;
- It was important that the drafting did not create a requirement to disclose in situations where disclosure would be contrary to law or regulation. Compliance with the Code cannot necessitate the accountant undertaking an illegal act;

- It would be useful if more guidance could be provided on the level of suspicion that would trigger the need to report in the public interest. The accountant only has a suspicion of an illegal act and the ultimate determination is up to the courts;
- Applicability to professional accountants in business:
  - The proposal that a professional accountant in business has the same obligation as a professional accountant in public practice might be too onerous in some situations. In particular, the requirement for an accountant to report up the organization in a sequential manner might not strike the right balance for a junior professional accountant in business;
  - Could a professional accountant in business having reported the matter to a supervisor rely on that supervisor to take the appropriate action?
- Member body support for accountants:
  - It was noted that this matter should be up to individual jurisdictions and not an obligation, for example, through the Statement of Membership Obligations (SMO). It was also noted that the issue of the method of calculating the compensation and support would need to be addressed if this recommendation went forward;
  - Some professions do have such support for whistle-blowing – for example, in some jurisdictions engineers have such support;
  - Mr. Franchini noted that the Task Force felt that it was important for professional accountants in business, in particular, to have support from member bodies but if this was not outlined in the SMOs this would not change the Task Force's recommendation. He further noted that the Task Force did not consider the Code to be the place to discuss methods of calculating the level of financial support. This would be a matter for Member Bodies if they supported such an approach;
- Public interest factors:
  - It was important that the drafting make it clear that all three factors would not have to exist and there may be other considerations;
  - Whether disclosure is in the public interest will always ultimately be a decision that the individual has to make and different individuals will have different thresholds;
  - The threshold of whether disclosure is in the public interest needed to be appropriately set. For example it would not be appropriate to require a professional accountant to disclose all minor frauds;
  - The first factor, significance to financial reporting, would seem to indicate that if two entities (one large and one small) engaged in the same level of money laundering, the matter would have to be disclosed outside of the smaller entity because of the significance to financial reporting but disclosure would not be necessary for the larger entity. This did not seem to be the right answer because what was important was the significance vis a vis the public interest;
  - With respect to the third criteria of likelihood of recurrence this could be interpreted as meaning that no disclosure was necessary if there was an assurance from management that there would be no repetition of the illegal act;

- It might be useful for the Task Force to think of some scenarios where reporting would not be in the public interest.
- Obligation to disclose versus right to disclose
  - It was noted that the drafting did not seem to provide for a middle ground. In other words, circumstances where there may not be an obligation to disclose but the accountant might still determine that disclosure was appropriate;
  - At the September CAG meeting, the view had been expressed that if a matter was significant there should be a right for the accountant to disclose but as the significance of the matter increased it would get escalated and become a duty to disclose because disclosure was in the public interest;
  - The balance between confidentiality and the public interest was important.
- Disclosure unless the outcome is disproportionate:
  - A view was expressed that the Task Force should give further consideration to the alternative requiring disclosure if it is in the public interest unless the outcome is disproportionate. If a possible outcome was physical harm, disclosure should not be required;
  - A contrary view was expressed that a disproportionate test might not strike the right balance because some accountants might conclude that a loss of employment or income was disproportionate.
- Reporting to whom?
  - A question was raised as to when a professional accountant would report to the shareholders of a company. It was noted that while those charged with governance represent the shareholders in a listed entity, in a private company with a minority shareholder this would not be the case;
  - The matter could be quite complicated in the case of a transnational company. For example, if the parent's auditor encounters an illegal act in a subsidiary in another jurisdiction, there may be no appropriate authority to report to in that jurisdiction. In such circumstances, reporting to the appropriate authority in the parent jurisdiction would not be effective;
  - A question was raised as to whether it was appropriate to require disclosure in circumstances where there was no appropriate regulator or authority to receive the disclosure.
- Depending upon the final position reached by the IESBA, there may need to be some conforming amendments to ISA 240 and 250.

#### *Alternative Approach*

A suggestion was made that a three-step structure to the approach might be helpful:

- The first step would be a principle that a disclosure in the public interest overrides the fundamental principle of confidentiality;
- The accountant should not have to seek consent to disclose the matter if such disclosure is in the public interest;
- There should be an obligation for the accountant to disclose in the public interest only if the following pre-requisites are present:
  - Disclosure is not contrary to laws and regulations;

- A whistle-blowing protection scheme is in place that affords both anonymity and protection from liability;
- There is an appropriate authority to receive the disclosure and there is a judicial process that can be trusted.

The IESBA discussed this approach and the following points were noted:

- A view was expressed that this approach seemed to provide an appropriate balance between public interest and confidentiality; and
- It was important to consider the cultural norms. For example, in some jurisdictions the principle of confidentiality is paramount and is in the public interest because it fosters and builds trust.

On behalf of the Task Force, Mr. Franchini thanked all Board members for their valuable input, which will be carefully considered by the Task Force in moving forward.

## **6. Conflicts of Interest**

Mr. Niehues introduced the topic. He noted that the Task Force met twice since the November IESBA meeting. The IESBA's activities have focused on revising the description of a conflict of interest (COI), determining the structure of Sections 220 and 310 of the Code, and considering the content to be included in those Sections.

### *Description of a COI*

Mr. Niehues reported that with respect to the proposed description of a COI, the Task Force believes there may be confusion as to whom the phrase, "other than with that party" may pertain to. The Task Force therefore is proposing explanatory language to provide further guidance concerning parties that can be involved in a COI. He explained that the explanatory language proposed by the Task Force includes two types of COIs: (1) conflicts between professional accountants and third parties and (2) situations where the professional accountant is undertaking professional activities for two or more parties whose interests compete or conflict.

Mr. Niehues presented the revised description of a COI and the proposed explanatory language to the IESBA:

"A conflict of interest arises if, when undertaking a professional activity for a party, a professional accountant has an interest or relationship other than with that party that creates a threat to objectivity and may create threats to compliance with other fundamental principles. Such threats may be created by:

- Conflicts between the interests of two or more parties for whom the professional accountant undertakes professional activities; or
- Conflicts between the interests of the professional accountant and the interests of a party for whom the professional accountant undertakes a professional activity."

Mr. Niehues further explained that the Task Force concluded that the description of a COI should be included in all three parts of the Code with a high level description in Part A of

the Code that would be applicable to all professional accountants and more precise descriptions in Parts B and C of the Code applicable to professional accountants in public practice and professional accountants in business, respectively. Specifically, the general description of a COI would be located in its own subsection under Section 100 since a COI is linked to all of the fundamental principles. The more detailed description of a COI would be located in Sections 220 and 310.

The IESBA was asked for its approval to include a high level description of a COI in Part A of the Code and two additional precise descriptions of COIs applicable to professional accountants in public practice and professional accountants in business in Parts B and C of the Code, respectively.

The question was raised as to why the Task Force decided not to include a description of COI in the definition section at the end of the Code and expand on the description in Parts B and C. Mr. Niehues explained that based on feedback received from the IESBA at its November meeting, the IESBA appeared to prefer a *description* of a COI and believed there were differences in COIs for professional accountants in public practice and professional accountants in business. Since the Task Force drafted a description of a COI rather than a definition, it did not believe a definition of COI in the definition section was appropriate.

Some members of the IESBA believed that adding a definition in the Code in addition to the descriptions proposed by the Task Force could be beneficial while others believed a definition was not necessary. Based on a straw vote, there was not sufficient support to move forward with a definition. Mr. Dakdduk noted that two of the three public members on the IESBA voted in favor of including a definition and therefore recommended the IESBA at a minimum include a question in the Exposure Draft asking respondents whether they believed a definition of a COI the Code would be helpful. Mr. Niehues noted that he did not believe the Task Force would oppose the inclusion of a definition in the Code provided the definition was consistent with the language used in the high level description of a COI. He agreed to have the Task Force further consider this issue.

#### *Proposed Structure of Sections 220 and 310*

Mr. Niehues reported that the Task Force believes the content for Sections 220 and 310 of the Code should be ordered in the same manner and proposes the following order:

- Description of a COI;
- Specific examples of COIs;
- Reasonable and informed third party test in identifying a COI;
- Identifying and evaluating the significance of a COI; and
- Management techniques for COIs.

He explained that with respect to the reasonable and informed third party test, the Task Force believes the discussion should be contained in a stand-alone paragraph in each Section following the specific examples of a COI so that the professional accountant can

consider the situation from a reasonable and informed third party's perspective early in the identification process.

The IESBA was asked to provide feedback on the proposed structure of Sections 220 and 310. Certain members suggested that the reasonable third party test currently located in proposed paragraph 310.3 be moved to proposed paragraph 310.4 since it is an identification technique. Mr. Niehues explained that it was the Task Force's intent to require that the professional accountant consider the views of a reasonable and informed third party early in the process and that the stand-alone paragraph stress the importance of the reasonable third party test. A Task Force member stated that the reasonable third party test should be considered in all phases of a COI situation, specifically during the identification and evaluation process and when implementing management techniques. Mr. Niehues agreed to have the Task Force consider redrafting the language to specifically state this intent.

#### *Examples of COIs and Potential Revision of Section 320*

Mr. Niehues discussed the proposed examples of COIs applicable to professional accountants in public practice and professional accountants in business. He noted that the Task Force had requested examples of COIs for professional accountants in business but that most examples received dealt with undue influence rather than COIs as described by the Task Force. Based on the number of examples dealing with undue influence, the Task Force believes it would be useful to have additional guidance in the Code on ethical behavior. Specifically, the Task Force believes the guidance in Section 320, *Preparation and reporting of information*, of the Code should be enhanced and agreed to take on this charge if the IESBA agrees. The IESBA agreed that the Task Force should expand its charge to include proposing additional guidance in Section 320.

One IESBA member recommended that the Task Force clarify that the examples of conflicts of interests included in the draft Sections 220 and 310 are not intended to be all-inclusive. Mr. Dakdduk agreed that this could be made clearer.

Another IESBA member suggested that the Task Force consider addressing the inherent COIs that exist as a result of pressures faced by professional accountants in business who have financial compensation arrangements that are tied to the company's financial reporting. It was noted that this issue could possibly be expanded on in Sections 320 or 340 of the Code.

#### *Management Techniques for COIs*

Mr. Niehues explained that Section 220 of the Code includes three examples of safeguards involving disclosure and consent and states that application of one of those safeguards is generally necessary. He stated that the Task Force believes that disclosure and consent is one possible management technique but that there should not be any one technique mandated by the Code. One IESBA member commented that there may be situations where disclosure and consent should be required depending on the specific circumstances. Mr. Niehues noted that language to cover such circumstances would be difficult to draft but agreed to have the Task Force consider this issue.

### *Network Firms*

Mr. Niehues stated that the Task Force agreed network firms should be addressed under the identification and evaluation discussion in Section 220 stating that threats to the fundamental principles should be evaluated when a firm has a *reason to believe* that there may be a conflict of interest due to an interest or relationship of a network firm. The IESBA discussed whether a more appropriate threshold would be to require professional accountants to *take reasonable steps to identify* interests or relationships of a network firm. The IESBA agreed that the interests and relationships of network firms should be taken into consideration and generally believed that the “reason to believe” threshold was appropriate. The Task Force was asked to consider, however, whether a requirement to “take reasonable steps” might be more appropriate.

### *Inclusion of the Term “Firm” in Section 220*

The IESBA was asked to consider whether Section 220 should include the term, “professional accountant *and the firm*” or whether it was clear that the term professional accountant included the firm since it was defined as such in the glossary of the Code. The IESBA generally agreed that it was not necessary to specifically reference the *firm* since the term is already incorporated into the definition of professional accountant. One IESBA member suggested that the Task Force consider the language “professional accountant, including the firm” to stress that language refers to both.

Mr. Niehues thanked the IESBA for its feedback and indicated that it would be carefully considered by the Task Force.

## **7. Definition of a Professional Accountant**

Mr. Rutherford introduced the topic. He reported that IFAC had formed a task force comprising a volunteer and a staff member from each of IFAC’s boards and committees. The Task Force provided input to IFAC staff as it developed a consultation paper assessing the current definition of the term *professional accountant*, which is defined as “an individual who is a member of an IFAC member body.”

The Task Force is responding to the following concerns about the existing definition:

- It is too simplistic and does not convey an understanding of the roles and functions of the professional accountant and, therefore, does not assist in the public’s understanding of the term;
- It does not recognize that professional accountants may not necessarily be members of IFAC member bodies; and
- It does not acknowledge that professional standards are *adopted and enforced* at the national/regional/state level through many different professional and regulatory arrangements.

IFAC staff developed a proposed new definition which:

- Provides an understanding of the breadth of competence, roles, and functions demonstrated by professional accountants;
- Encompasses professional accountants who are not members of IFAC member bodies but are still subject to qualification requirements and oversight; and
- Provides help in identifying users of the standards of IFAC's boards and committees and facilitates a better understanding of the term professional accountant by the public.

The following definition is proposed:

“The term *professional accountant* describes a person who has expertise in the field of accountancy, achieved through formal education and practical experience, and who:

- Demonstrates and maintains competence;
- Complies with a code of ethics;
- Is held to a high professional standard; and,
- Is subject to enforcement by a professional accountancy organization or other regulatory mechanism.”

The IESBA discussed the proposed definition and the following points were noted:

- Professional accountants do not comply with the Code, they comply with the requirements of their member body or organization and, as such the description of professional accountant contained in the Code is accurate;
- There would seem to be nothing in the existing definition that would prevent organizations that are not member bodies of IFAC from adopting the Code;
- “Formal” may not be needed in the proposed definition; perhaps it should refer only to “education”;
- If the definition referred to formal education *or* practical experience (instead of *and*), this would capture accountants who had completed the educational element of a qualification but not yet completed their practical experience. Such an approach would seem to facilitate the Code's applicability to young professional accountants, which would be beneficial;
- There have been many attempts to define a profession, all of which seem to be problematic if the definition attempts to do this by reference to what people do and their values. Such an approach is problematic because there is too much variety. What does work well is to link the definition to membership in a professional society;
- If the definition is changed to refer to a person who has expertise in the field of accountancy, it is important to have a clear understanding of what is meant by accountancy;
- The reference to accountancy is problematic because, for example, in some jurisdictions this would scope out tax professionals;
- Changing the definition to drop the reference to a member body might create a false expectation because without a mechanism such as the SMOs, there is no comfort of compliance with the Code;



- A more productive approach might be to ensure that all member bodies comply with the Code before expanding its remit to cover additional accountants;
- It is important to consider whether the objective is to broaden the applicability of the Code to as many accountants as possible or whether the objective is to have a more restrictive remit; and
- One approach might be to include members of IFAC member bodies and members of organizations that meet the criteria of an IFAC member body.

The IESBA agreed that it was difficult to discuss the issue without having a clearer understanding of the implications of the proposed change. The IESBA agreed that a small working group should be formed, chaired by Mr. Rutherford. The working group would examine the implications of the changes and brain storm any other possible approaches. The group would report back to the IESBA at its June 2011 meeting.

Mr. Dakdduk asked those IESBA members who were interested in participating in the working group to inform him or Ms. Munro. He noted that when Task Forces and working groups are formed, in addition to being sensitive to the interests of IESBA members as well as demands on their time, it was important to achieve an appropriate balance of representation.

## **8. Inadvertent Violation**

Ms. Spargo introduced the topic. She noted that the Code contains several paragraphs that address an inadvertent violation of a provision of the Code. These provisions were commented on by the International Organization of Securities Commissions (“IOSCO”) in its response to the IESBA's Drafting Conventions Exposure Draft. At its November 2010 meeting, the IESBA approved a project proposal to address this matter.

### *Need for Provisions to Address Inadvertent Violation of an Independence Requirement*

The Task Force considered whether the public interest continues to be served by retaining such provisions in the Code. The Task Force first considered the inadvertent violation provisions that relate to auditor independence and then considered the general inadvertent violation provision contained in paragraph 110.10. The Task Force took this approach because the discussion of an inadvertent violation tends to focus on independence and the Task Force felt that it would be useful to discuss the appropriateness of the provisions in the context of independence before discussing the appropriateness of the more general provision in paragraph 110.10.

In considering the need for such provisions, the Task Force identified the following objectives of the provisions:

- A distinguishing mark of the accountancy profession is its acceptance to act in the public interest;
- If a provision of the Code is violated, the public interest must still be protected;
- If the automatic consequence of any independence violation is the resignation of the auditor, regardless of the impact of the violation, the public may not be well served.

With this backdrop, the Task Force identified the following arguments for maintaining some provisions:

- Despite having policies and procedures in place to maintain independence, violations will occur from time to time;
- When an independence violation does occur it will call into question the firm's ability to continue with the audit. Firms should have to follow a consistent, rigorous, and transparent process to answer that question;
- Not all jurisdictions have a regulator or an adequate regulatory process for dealing with violations. The Code should address the matter for such jurisdictions.
- In many jurisdictions those charged with governance of the client have a responsibility to evaluate the independence of the auditors, including dealing with matters concerning independence violations. The Code can provide assistance to those charged with governance, such as audit committees; and
- Without such guidance, professional accountants and their firms would be left to deal with such situations on an ad hoc basis with no guidance to promote a consistent and transparent process.

The Task Force identified the following arguments against maintaining the provisions:

- The provisions could be viewed as providing an exception to a requirement under the Code, or allowing an easy avenue for a professional accountant to "cleanse" a violation. This may increase the risk of abuse or discourage professional accountants from focusing on compliance with the Code. This would not be in the public interest.
- The Code should focus on what is required and the consequences of an inadvertent violation should be left to those who have responsibility for enforcing the Code.
- Regulation should not include guidance on how to address violations of the provisions – for example, laws typically do not include provisions on how a violation will be addressed.

Ms. Spargo stated that the Task Force concluded that the Code should contain such provisions because the public interest will be better served by such provisions. The provisions can require action to be taken to mitigate the adverse consequences of the violation if possible and address what might, depending upon the situation, otherwise be a disproportionate outcome to the audit client (auditor resignation). The Task Force recognizes that significant concern has been raised with the current inadvertent violation provisions that relate to the independence requirements in the Code. The Task Force is of the view that it may be the drafting of the current provisions that may add to the concern as opposed to a notion that there is no need for an appropriate mechanism to address violations.

Having concluded that the Code should contain provisions to address this matter, the Task Force then considered whether "inadvertent" was the appropriate descriptor and, if so, whether any additional guidance should be given on its meaning. The Task Force

concluded that the designation of “inadvertent” was not helpful. If a violation has occurred, an analysis needs to be undertaken to determine whether actions can be taken such that the firm can provide the audit opinion or whether resignation is necessary. Whether the action creating the violation was inadvertent or not does not alter the fact that the firm needs to evaluate the implications of the violation and take action. Resignation from the audit can be a disproportionate outcome irrespective of whether the violation was inadvertent or not. The disproportionate outcome can be of the same magnitude whether the violation was inadvertent or not.

The Task Force reviewed the language “deemed not to compromise” and noted that concern had been expressed with the term. The Task Force noted other jurisdictions (for example, the SEC and APB) do not make what could be seen as a blanket statement that violations are “deemed not to compromise independence” (provided certain conditions are met). The Task Force is of the view that if an independence provision is violated, independence is by definition compromised and it is not, therefore, helpful to have language saying that it is deemed not to compromise independence. The Task Force is also of the view that the significance of a violation may be such that the audit cannot continue and resignation is necessary.

The IESBA considered the recommendations of the Task Force and the following points were noted:

- While it is important that the Code address inadvertent violations, it might not be appropriate to change the provisions to cover all violations “irrespective of how they occurred” because if there was a willful disregard of the provisions, independence might be compromised;
- If there were a number of breaches, this could be indicative of a more significant problem;
- While initially it might seem inappropriate to address all types of violations, having considered the arguments it did seem to be logical to focus on the outcome rather than the cause of the violation;
- The arguments presented in the paper were well reasoned and demonstrate how the public interest is served by maintaining the provisions provided that the steps taken to address the violation were sufficiently robust;
- The provisions were appropriate because violations will occur from time to time. While some jurisdictions might have mechanisms to address such matters, others do not. The proposal provides an appropriate and robust mechanism for addressing such situations;
- The proposal outlines what happens in practice when violations occur;
- Having provisions to address these matters is important in a network firm situation; and
- It is difficult to see how an individual would be acting with integrity if he or she willfully violated an independence provision.

Mr. Kuramochi stated that from the perspective of the Japanese FSA, this was an important issue. He reflected on the concerns expressed in the Monitoring Group report

that IESBA should clearly set standards in the public interest as opposed to in the interest of the profession. He expressed a concern with expanding the provisions to address not only violations that were inadvertent but also violations that were intentional. If such an approach were taken it could mean that it would be acceptable for a member of the audit team to invest in shares of the audit client provided the holding was not material.

It was noted that the proposals were not an extension of the existing provisions. The existing provisions provide that a firm could determine for itself how to address an inadvertent violation without disclosing the matter to the client. The proposed provisions would apply to all violations, would specify a number of factors to consider, and would require disclosure to those charged with governance. The proposed revisions, therefore, would strengthen the existing provisions in the Code.

Mr. Kuramochi stated that regulators were not convinced that there were resignations due to such breaches and, therefore, there seemed to be other mechanisms to address the matter. If other mechanisms exist, it is not necessary for the Code to address the matter. Mr. Dakdduk noted that while such mechanisms might exist in some jurisdictions, the IESBA could provide leadership for those jurisdictions where there is no such mechanism. The IESBA could also provide guidance on the steps that should be taken in such circumstances.

A view was expressed that it was inappropriate to provide that those charged with governance have the ability to set a threshold below which no violations would be disclosed by the auditor. Firms should be required to disclose every violation. Providing those charged with governance with the opportunity to establish a threshold would mean that auditors would be in a position to interpret that threshold, creating the potential for inconsistencies in what is disclosed by firms. Also, if there are many trivial violations, this may be indicative of a weakness in the firm's systems. If a matter truly was trivial, those charged with governance could quickly deal with the matter.

IESBA members expressed support for the maintaining the independence provisions for the reasons expressed in the agenda paper. IESBA members also expressed support for addressing all types of violations but felt that further thought should be given to the concerns raised about willful disregard of the provisions.

#### *Types of Violations*

Ms. Spargo reported that the Task Force considered whether the provisions should apply to all independence violations or be limited to, for example, only violations of the financial interest provisions. The Task Force identified examples that related to partner rotation and also scope of services. The Task Force concluded that what was relevant was the consequence of the violation as opposed to the interest or relationship that caused the violation. For example, if the consequence of the violation is that the audit client is required to find a replacement auditor to complete the audit, it would not matter whether the violation was created by the holding of a prohibited financial interest or the provision of a non-assurance service. The impact of the violation and, therefore, the actions to be taken to address the violation may differ, but both types of violation need to be addressed.

The IESBA discussed the Task Force proposals and the following points were noted:

- While the examples were useful to illustrate the importance of the provisions addressing all types of violations, the Code itself should not contain the examples;
- The example of partner rotation was not a good one because the firm should have policies and procedures to monitor the requirements; and
- The scope of services example is particularly problematic in light of the complexity of the related entity definition.

IESBA members expressed support for the provisions to apply to all independence violations.

Mr. Kuramochi stated that IOSCO was of the view that if an inadvertent violation provision was retained in the Code, there should be a sufficiently narrow and prescriptive definition of the term “inadvertent” and a materiality threshold for evaluating when an inadvertent violation could and could not be deemed to compromise independence. He expressed his personal view that eventual convergence is in the public interest but retaining an inadvertent violation provision in the Code could be seen as against the public interest.

#### *Comments on Drafting*

The IESBA reviewed the tentative drafting of the provisions and the following points were noted:

- There should be greater emphasis on the need to have policies and procedures to monitor independence and there should also be a recognition that violations could be an indication that the policies and procedures are deficient;
- All violations should be reported; providing an exemption for trivial matters undermines the strength of the provisions;
- The second sentence of paragraph 290.40 conveyed the impression that the auditor was trying to retain the audit and perhaps it should be recast to state that resignation would be necessary unless certain conditions were met;
- Paragraph 290.45 should be strengthened to make it clear that those charged with governance needed to agree with the decisions taken;
- It might be appropriate to require non-trivial violations to be reported immediately and with trivial matters being disclosed on an annual basis;
- Paragraph 290.47 should be compared to the European recommendation of May 16, 2002, so that we do not adopt a provision that is less stringent than the recommendation;
- The provisions are focused on violations identified during the current audit. A violation could relate to a prior audit, in which case the impact on the prior audit would need to be considered;
- The phrase “resolve the situation” is not clear. It should be clear that this does not imply that the resolution takes into account the self-interest of either the firm or the client – it is the public interest that should take precedence;

- The significance of the violation should also take into account whether the action leading to the violation was intentional, the role of the person who committed the violation, and whether that individual was a member of the engagement team; and
- There seems to be some inconsistency between paragraphs 290.40 and 290.41(b) both of which refer to termination of the interest or relationship that caused the violation.

*Need for Provisions to Address other Parts of the Code*

Ms. Spargo reported that the Task Force considered whether the Code should address violations of other provisions in the Code. The Task Force felt that the consequences of other violations differed from the consequences of a violation of an independence provision. A distinguishing feature of the independence provisions is the consequences the violation – if independence is violated and the firm cannot issue the opinion, the company would need to find another auditor and, depending upon the timing, might have difficulties meeting filing requirements. If the violation was trivial or inconsequential the consequences would, therefore, be disproportionate to the violation. In the case of the other provisions in the Code, there are not the same consequences to the public. Given that the objective of the provisions should be the protection of the public rather than the accountant, the Task Force is of the view the provisions should address only independence and, therefore, paragraph 110.10 should be deleted.

The IESBA discussed the matter and the majority of members agreed that the provisions should apply only to the independence requirements.

Ms. Spargo thanked IESBA members for their comments and indicated that they would be carefully considered by the Task Force.

**9. IFAC Public Interest Exposure Draft**

Ms. McCleary introduced the topic. She indicated that she, Mr. Gaa and Mr. Kwok had met to consider the IFAC Exposure Draft containing a policy position paper “A Public Interest Framework for the Accountancy Profession.”

Ms. McCleary noted that it was the understanding of the group that the purpose of the framework presented in the paper was to enable IFAC and its Public Interest Activity Committees (of which the IESBA is one) with a framework to have a common understanding of the public interest. The paper provides a public interest framework containing three criteria and seeks to address who is the public and what are its interests.

The public is defined as “The widest possible scope of society” and includes financial preparers and auditors, corporate boards, stakeholders, governments and electors and taxpayers. Their interests are considered to be “all things valued by society.” This includes: sound financial reporting; comparable reporting across jurisdictions; reduced economic uncertainty; and high standards of ethical behavior and judgment, among other things.

The three criteria for addressing the public interest are:

- Consideration of costs and benefits for society as a whole;
- Adherence to democratic principles and processes;
- Respect for cultural and ethical diversity

Ms. McCleary indicated that the working group's overall preliminary thoughts on the paper were as follows:

- It is very difficult to define the public interest, although many have tried; and
- The application of the scope of the paper to IFAC needs to be clearer.

With respect to the first criterion regarding the consideration of costs and benefits to society as a whole, the working group was concerned that while this was a good goal it was not practical or operational as a criterion. It was not clear to the working group how this criterion would be useful for measuring the decisions made by IESBA.

With respect to the second criterion regarding adherence to democratic principles and processes, the working group viewed this as describing the due process and accountability that IFAC and its Boards and Committees strive to achieve.

With respect to the third criterion regarding cultural and ethical diversity, the working group felt that this was part of the second criterion. To have validity, international bodies would need to take this into account.

The IESBA discussed the paper and the preliminary views of the working group and the following points were noted:

- The paper did not assist IESBA members in their thinking as to how decisions would be made in the public interest;
- In looking at the cost/benefit trade-off for society as a whole, it was difficult to see how this could be measured on a world-wide basis;
- While it was necessary and appropriate for IESBA to perform an impact analysis to demonstrate how the public interest had been taken into account, it was difficult to see how the paper would assist in this regard;
- The paper includes cost/benefit as a criterion but it would seem to be impossible to satisfy the criterion – a fact the paper acknowledges;
- It might be more helpful to have one criterion that referred to adherence to due process with good democratic principles;
- The definition of public interest would include consideration of the costs to auditors. If this were to be applied, for example, to the inadvertent violation project, it would lead to a significantly different result than if one thought about the cost to, for example, shareholders. It was, therefore, important to balance the various interests and determine which one should take priority;
- While outreach is very important, a focus on only the process is not appropriate, it is also necessary to focus on the outcome;
- The paper is academic and at a very high level and does not provide practical assistance in considering the public interest;

- A simpler approach might be to think of the public interest as the lack of self-interest. When there is a conflict between self-interest and public interest, it is the latter that should take priority;
- A definition of the public interest is both necessary and appropriate. If a business had a stated objective, you would expect to see some definition of that objective. The Code contains several references to the public interest but there is no description of what is meant by this term;
- The concept of public interest for the individual accountant is very different from the concept of public interest for a standard setter. The paper seems to mix these two elements;
- The document should give greater focus to the public accountant's main role, which is related to the audit of financial statements; and
- The document is useful in that it establishes some high level principles that go behind standard setting and the way IESBA works. In this regard it will be useful for new members and the public to explain what it is that IESBA does. What is missing from the paper is a more robust discussion of what the public interest is.
- The Task Force dealing with Responding to Suspected Fraud and Illegal Acts had considered the paper but did not find it helpful in framing the appropriate approach.
- In the board's discussion of the project on suspected fraud and illegal acts, it was noted that the public would likely expect that members of the accounting profession would embrace a higher duty of disclosure than the average person. Such an expectation was thought to be illustrative of the public's trust in the profession. And, respecting that trust and living up to it could be viewed as acting in the public interest.

Ms. McCleary thanked IESBA members for their comments and turned to the subject of how the IESBA should respond to the exposure draft. The Working Group considered three difference approaches:

- A formal response that would be on the public record;
- A written response that would not be on the public record; and
- A verbal response.

Dr. Kitamura indicated that the PIOB had discussed the concept of public interest in its previous annual reports. He noted that he expected the PIOB's sixth annual report to contain a more in-depth discussion of the public interest.

Ms. McCleary stated that it was the recommendation of the Working Group that the IESBA provide verbal comments. The Working Group felt that this would be a more constructive approach and was also consistent with ensuring that IFAC spoke with one voice. The IESBA discussed the Working group recommendation and the following points were noted:

- As an independent Board of IFAC, the IESBA can issue a letter that would be on the public record;



- A written response that was not on the public record would have the advantage of providing a specific response but would avoid the possibility of conflicting with any discussion that might be included in the sixth PIOB report;
- A written response generally puts more rigor into the process; and
- The concept of public interest is and will continue to be an evolving subject. Probably the best that can be done is to provide some directional guidance to advance the objective. In that respect it would be very difficult to develop a written response because such a response would need to propose an alternative definition to be helpful.

The IESBA agreed that it would provide a verbal response to the exposure draft. It was agreed that the Working Group, chaired by Ms. McCleary, would develop the comments based on the input received at the meeting.

Mr. Dakdduk thanked Ms. McCleary and the Working Group for their work.

## **10. Internal Audit**

Mr. Franchini introduced the topic. The International Auditing and Assurance Standards Board (IAASB) has a project to revise ISA 610 *Using the Work Of Internal Auditors*. One of the subjects addressed by the project is the expansion of the scope of ISA 610 to address instances of internal audit staff providing direct assistance to the auditor. Given the linkage with the Code of Ethics, the IAASB extended an invitation to the IESBA to appoint a task force member. The IESBA accepted the invitation and Mr. Franchini has been a correspondent member on Task Force for more than a year.

At previous meetings, the IESBA considered whether by performing audit procedures on the external audit, internal auditors may, under the prevailing definitions in the ISAs and the IESBA Code, be deemed to be members of the engagement team?<sup>1</sup> The IESBA concluded that the definition of engagement team in the IESBA Code did not encompass internal auditors providing direct assistance to the external auditor.

The IAASB issued an exposure draft in July 2010. Many respondents to the exposure draft commented on the interaction of the definition of engagement team and the provision of direct assistance by internal auditors. Some respondents expressed the view that because of the definition, direct assistance would not be permitted as this would compromise independence. Other respondents expressed the view that the definition of engagement team should be changed to make it clear that internal auditors providing direct assistance would not be considered to be members of the engagement team.

Mr. Franchini reported that the IAASB Task Force considered the matter and were of the view that it would be appropriate to clarify the definition of engagement team. He noted that the matter would be discussed with the CAG at its meeting in March.

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<sup>1</sup> The engagement team is defined as all partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external experts engaged by the firm or a network firm.

It was agreed that Mr. Franchini, Mr. Dakdduk, and Ms. Munro would develop a recommendation on how the IESBA might proceed for consideration at the IESBA's June 2011 meeting.

### **11. EU Green Paper**

Ms. Sapet introduced the topic. She noted that the EU had recently issued a summary of responses received to the Green Paper *Audit Policy: Lessons from the Crisis*. Almost 700 responses were received, with the majority from EU member states.

Ms. Sapet presented a summary of the comments received.

It was noted that the EU would be holding a forum in Brussels on February 10, 2011 which would be attended by some IESBA members. The IESBA agreed that it would closely monitor developments with the view to better informing the IESBA of issues it may wish to address as a result of comments to the Green Paper.

The Planning Committee will hear from those who attended the forum and will consider the issues in the paper and discussed at the forum to determine what the IESBA's next steps might be.

Mr. Holmquist did not participate in this section of the agenda.

### **12. Remarks from the PIOB**

Mr. Dakdduk invited Dr. Kitamura, representing the PIOB, to make some remarks.

Dr. Kitamura stated that this was the second time he had observed an IESBA meeting. Before attending this meeting he noticed that 2010 was missing in a new draft of the Strategy and Work Plan 2011 and 2012, but then recognized that the IESBA members had continued active discussions of this paper throughout 2010, which resulted in approval of the final document on the first day of the meeting. He noted that he understood that at the November IESBA meeting there were differing arguments about whether the plan should address the collective investment vehicles project. He noted that if this Strategy and Work Plan is submitted to the PIOB, it will review it in the context of these difficult arguments.

During the current meeting, he sensed the increasing awareness of the "public interest" in and outside the IESBA and IFAC. He noticed a variety of views in the IESBA discussion arising from the IFAC's Policy Position Paper, A Public Interest Framework for the Accountancy Profession. He also noted that during the current IESBA meeting, some IESBA members referred to the EC Green Paper, which is highly challenging and which, in a sense, originates in the public interest framework. He agreed that the concept of the public interest is quite broad and multifaceted, that it could be as specific as possible in the context of socio/economic arguments, and that it has an evolutionary nature in line with the changes in society and market. The PIOB will likely discuss this issue in the forthcoming 6th Public Report.

In the IESBA discussion of the Monitoring Group report, he noted that some concerns were expressed about the meaning and role of "practitioner/non-practitioner" and emphasis was suggested on the role of chairmanship based on integrity.

Dr. Kitamura noted that the IESBA spent a lot of time on the description and definition of "Conflicts of Interest." In the eyes of those outside the accountancy profession, this "COI" issue is highly difficult. Comment letters on the Strategy and Work Plan were generally supportive of this project, which was confirmed last November. In view of these strong interests and the IESBA's earnest discussions, the PIOB will continue to monitor and review the argument process of this issue.

With respect to the project addressing a Suspected Fraud or Illegal Act, Dr. Kitamura noted that the PIOB will be interested in the forthcoming CAG discussions on this issue and in particular the balancing of the principle of confidentiality and the public interest.

With respect to the discussions on inadvertent violations, Dr. Kitamura indicated that the PIOB will also be interested in the forthcoming CAG discussions and will continue to follow and review the developments on the project.

Mr. Dakdduk thanked Dr. Kitamura for his comments.

### **13. Closing Remarks and Future Meeting Dates**

Mr. Dakdduk invited Mr. Jaydeep N. Shah to make some final remarks. Mr. Shah thanked the IESBA for meeting in New Delhi and extended an invitation to other IFAC Boards and Committees to meet in New Delhi.

Mr. Dakdduk thanked all participants for their attendance and the ICAI for its kind hospitality in hosting the meeting.

Mr. Dakdduk closed the meeting.

#### *Future meetings of IESBA*

- February 20-22, 2012 - Location TBD
- June 18-20, 2012 - Location TBD
- October 15-17, 2012 - Location TBD