

## Agenda Item 2



**Meeting Location:** Conrad Ballroom, Conrad Hotel, Dublin, Ireland

**Meeting Date:** February 20-22, 2012

### Breach of a Requirement of the Code

#### Objective of Agenda Item

1. To discuss key issues raised on exposure and to provide feedback to the Task Force.

#### Background to the Project

On October 24, 2011, the IESBA issued an exposure draft (Agenda Paper 2-A) proposing changes to the Code related to provisions addressing a breach of a requirement of the Code. The comment period ended on January 23, 2012 and 43 responses have been received as at February 9, 2012.

The Task Force met on February 3-4, 2012 to review the comments received. The Task Force reviewed all comments and has identified some key issues on which it would like the direction of the IESBA. In particular the Task Force focused on the first five questions raised in the exposure draft. The Task Force will consider the remaining three questions (impact analysis, proposed effective date and approach in Section 291) in detail in a future Task Force meeting.

#### Matters for Discussion

##### *Overview of Responses Received*

43 responses have been received (for a complete listing of responses please see Appendix A to this agenda paper). All the responses have been posted on the website and can be accessed here <http://www.ifac.org/publications-resources/proposed-changes-code-ethics-professional-accountants-related-provisions-addr>.

Category	Number
IFAC Member Body	26
Firms	7
Regulators and Public Authorities	4
Other Professional Organizations	6
<b>Total</b>	<b>43</b>

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*Q1 Do respondents agree that the Code should contain provisions that require professional accountants to address the consequences of a breach of a requirement of the Code? If not why not?*

40 respondents responded that the Code should contain provisions that require a professional accountant to address the consequences of a breach of a requirement of the Code. Illustrative comments are as follows:

- It appears disproportionate and may not serve the public interest if even a minor breach of a requirement of the Code automatically compels a firm to resign from an audit engagement, irrespective of the magnitude of the breach and its impact on the firm's objectivity. (JICPA);
- We welcome the publication of the Exposure Draft and are fully supportive of the IESBA's goal to provide a robust framework in the Code for addressing a breach of an independence requirement. We support the use of the term "breach" rather than "violation" and concur with the Board's view that whether the action causing the breach was inadvertent or not should not affect the need to focus on the impact on the firm's objectivity and the actions necessary to address the consequences of the breach. (KPMG);
- We agree with the IESBA's view that any breach of a provision of the Code should be treated as a matter of utmost importance and a professional accountant should be required to take whatever actions that might be available to satisfactorily address the consequences of a breach of a provision of the Code. The proposal to remove the exception for 'inadvertent' violations emphasizes the seriousness of violations and reinforces the requirement that all breaches must be appropriately addressed. (CPAB); and
- We see the Board's efforts as a significant step in the right direction to promote independence and objectivity by professional accountants. Specifically, we recognize the Board's move away from the notion of an "inadvertent violation" (IOSCO).

Three respondents expressed the view that the Code should not contain such provisions. Two respondents (ICAEW and KICPA) expressed the view that the Code should not include such provisions because addressing the consequences of a breach of the Code is within the purview of those who enforce the Code (such as professional bodies and regulators). One respondent (WpK) felt that there should be no further amendments to the Code at this time because of the demands on member organizations in terms of implementation and regulation. The respondent noted that to the extent that IESBA felt clarification was necessary this should be done by a guidance paper.

The Task Force has considered all of the responses to question one and, notwithstanding the view expressed by three respondents is of the view that the majority support indicates that the Code should contain such provisions.

**Action Requested**

IESBA members are asked to confirm whether they agree the Code should contain provisions to address a breach of a requirement of the Code.

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*Question 2 Do respondents agree with the overall approach proposed to deal with a breach of an independence requirement, including the proposal that the firm may continue with the audit engagement only if those charged with governance agree that action can be taken to satisfactorily address the consequences of the breach and that such action can be taken?*

33 respondents expressed agreement with the overall approach, though 10 respondents explicitly stated that their support was subject to their responses to the third question as to whether all breaches should be discussed with those charged with governance. Some of those expressing support for the overall approach questioned the timing of the discussion of all breaches – this is discussed in further detail under question three below. Illustrative comments supporting the overall approach are:

- The proposed revised provisions are much more rigorous and precise than the existing ones and professional accountants will appreciate the clear guidance given. Having those charged with governance concur that action can be taken to satisfactorily address the consequences of the breach adds to the credibility and objectivity of the action taken. (ICPAS); and
- We generally agree with the proposed changes with respect to independence violations and support the approach that the continuance with the audit engagement, after an independence breach has been reported, should only be with the active agreement of those charged with governance. (E&Y).

Eleven respondents stated that they did not support the proposal that the firm could only continue with the engagement if those charged with governance agree with the proposed actions. Five of the respondents (AAT, CPAAu, ICAA, IRBA and AGNZ) expressed the view that the decision must be made by the auditor. Illustrative comments are:

- ... the proposal put forward ... could be seen to be devolving ethical decision-making to a third party who cannot and should not reasonably be expected to have an in-depth knowledge and/or understanding of the Code of Ethics in the same way that the practitioner should. (AAT);
- We do not think the professional judgement and determination of the firm should be challenged by those charged with governance, as this is not only unnecessary but it may also give the impression that the firm's determinations can be questioned in other matters. In addition the client is able to terminate an audit engagement without the necessity of the proposed paragraphs. (CPAAu); and
- In our opinion, those charged with governance are primarily required to make decisions in the best interests of the organisation. From our observations such decisions may not necessarily reflect the public interest. For example, in New Zealand those charged with the governance of companies (the directors) are required by legislation to act in "the best interests of the company". In our opinion, "the best interests of the company" do not necessarily align with the public interest. (AGNZ)

One respondent (AIA) stated that "...there is a risk that informing those responsible for governance could sometimes be viewed as an alternative to stepping down. It may be that management would prefer the auditor to continue for the sake of avoiding the disruption of appointing a replacement late in the reporting cycle."

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One respondent (FAR) stated that while they agree there should be a discussion with those charged with governance “it is doubtful as to whether those charged with governance will feel obligated to follow the Code’s regulations as to which matters are discussed and how they are to be dealt with.”

One respondent (KICPA) stated that consideration should be given to “each jurisdiction’s diverse situation where: 1) those charged with governance are ineffectively operated and do not meet the role the IESBA expects, or 2) only a regulatory body determines whether to terminate audit engagements. Therefore, we suggest that those who we communicate with when an inadvertent breach of an independence requirement is occurred should be revised to “those charged with governance, regulatory bodies or professional bodies.”

One respondent (IDW) felt that it would be problematic for audit committee agreement to be required in the case of any identified breach and a differentiation should be made with respect to the significance of the breach. The respondent noted that “such a proposal places responsibilities on those charged with governance that they may be reluctant to accept. Such a measure might lead to their adopting overly cautious stances as they will seek to avoid the risks to themselves of being accused of having made wrong decisions, potentially leading to ill- or unfounded auditor withdrawals, and resultant disruption for audit clients and firms alike. Secondly, in many jurisdictions auditor withdrawal is governed by law and may – for good reasons – be restricted to certain limited circumstances.” In its response to the fifth question in the exposure draft, this respondent also noted that while those charged with governance should be involved in the discussion of breaches “the IESBA should not prescribe a right of veto (290.48) in this context, since the role of those charged with governance does not fall within its mandate.”

One respondent (WpK) noted that in Germany changing statutory auditors is not at the discretion of those charged with governance or the auditor. In the case of an audit that is not a statutory audit it is already possible for both parties to mutually terminate the audit. The respondent noted, therefore, that the provisions are not appropriate.

One respondent (DTT) disagreed with the overall approach based on three matters:

- It is inconsistent with ISA 260 *Communications with Those Charged with Governance*, in terms of both the timing of the communication (this matter is discussed in greater detail below under question 4) and the persons to whom the communication is made;
- It is inconsistent with the Board’s objective of convergence – the need to communicate all breaches, irrespective of magnitude, as soon as possible (discussed in more detail under question 3 below); and
- The overly prescriptive nature of the proposed approach – all breaches are treated in the same manner, the need to communicate all breaches and the timing (again discussed in more detail under question 3 below).

The Task Force has considered all the responses to the question. The Task Force is of the view that it was not the intent of the IESBA to devolve responsibility to those charged with governance and does not believe that the language implies this but will see whether this can be made clearer as it redrafts. The Task Force notes that the Code currently does not contain any instances where the accountant is required to obtain the

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approval of those charged with governance. The Code currently contains (list is illustrative but not all inclusive):

- Consultation with those charged with governance ¶100.19
- Discussion with those charged with governance ¶200.13, ¶280.14, ¶290.34, ¶290.35, ¶290.39, ¶290.117, ¶290.133, ¶290.141, ¶290.174
- Disclosure to those charged with governance ¶200.13
- Inquiry of those charged with governance ¶200.14
- Communication to those charged with governance ¶290.28
- Those charged with governance request the auditor to continue ¶290.35, ¶290.36

ISA 260 *Communication with Those Charged with Governance* deals with communication. The revised ISA 610 *Using the Work of Internal Auditors* refers to communication with those charged with governance and in the area of direct assistance will require:

“The external auditor shall, in communicating with those charged with governance an overview of the planned scope and timing of the audit in accordance with ISA 260,<sup>1</sup> communicate the nature and extent of the planned use of internal auditors to provide direct assistance so as to reach a mutual understanding that such use is not excessive in the circumstances of the engagement.”

**Action Requested**

IESBA members are asked to consider the comments received on obtaining the agreement of those charged with governance and provide their views on whether a change should be made.

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<sup>1</sup> ISA 260, *Communication with Those Charged with Governance*, paragraph 15

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*Question 3 Do respondents agree that a firm should be required to communicate all breaches of an independence requirement to those charged with governance? If not why not and what should be the threshold for reporting?*

### Summary of Responses

	Report all breaches (subject to comments marked by asterisks)	TCWG can establish threshold for types of breaches reported	Don't communicate insignificant/ trivial breaches	Report to a regulator	Other
Member Body	AAT, CICA <sup>1</sup> , CICPA, CPAAU HKICPA, ICAS, ICPAS, JICPA, MIA, SAICA, CND- CEC, NASBA, ICAEW <sup>2</sup> , WpK	AICPA	ACCA, CNCC- OEC, FSR, ICJCE, ICAA <sup>5</sup> , CGA, IDW, FAR	NASBA – firm may wish to also report to a regulator  ICPAR	AIA (investor disclosure if significant), ICPAR (threshold for regulator) KICPA (leave it up to auditor's judgment)
Firms	PwC <sup>3</sup> , BDO <sup>3</sup> , E&Y. <sup>5</sup> , KPMG <sup>3</sup>	PwC, GTI <sup>5</sup> , DTT <sup>5</sup>	DTT, Mazars		
Regulators	CPAB, CARB <sup>2</sup> , IOSCO, FAOA <sup>4</sup>			IOSCO – if such reporting is encouraged in the jurisdiction	IRBA (only communicate breaches where objectivity is compromised)
Other Prof Organizations	NZAuSB, AGNZ	APESB <sup>5</sup> ASSIREV <sup>5</sup>	FEE, APESB, ASSIREV		AGNZ, NZAuSB – audit report to disclose non- trivial breaches

Some respondents indicated two options would be acceptable – these respondents are designated in *italics* in the above table.

- 1 One respondent expressed the view that minor breaches be communicated to the chair of the audit committee
- 2 Three respondents expressed the view that insignificant breaches did not need to be reported as soon as possible
- 3 Three respondents expressed the view insignificant breaches should be reported in accordance with a timetable agreed with those charged with governance
- 4 One respondent expressed the view that the audit report should also disclose all facts that might lead to the presumption that independence is impaired
- 5 Six respondents expressed the view that the timing of communication should be on a “timely basis” to be consistent with ISA 260, “as soon as practicable” “without delay” or “in a timely manner” rather than “as soon as possible”

Responses to this question were mixed with 24 respondents agreeing with the proposal that all breaches be communicated to those charged with governance. Illustrative comments supporting this approach include:

- Providing complete information in relation to breaches will place those charged with governance in a better position to evaluate whether to what extent the identified breaches will impair the firm's objectivity and ability to issue an assurance report. This enhances the discharge of governance responsibility on behalf of the board of directors. (MIA);
- All breaches of an independence requirement should be reported to those charged with governance. Subjectivity would introduce opportunities for

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abuse. A requirement to report all breaches promotes transparency, which we believe to be appropriate. (NZAuSB)

Seven respondents expressed the view that while all breaches should be communicated to those charged with governance, the significance of the breach should effect the communication. Four respondents (BDO, E&Y, KPMG, and PwC) expressed the view that while all breaches should be reported, those charged with governance should be able to determine the timing of the communications by the firm. Respondents noted that this would enable those charged with governance consider the less significant breaches in accordance with their normal schedule of meetings. Two (ICAEW and CARB) felt that the timing of the communication would depend upon the significance of the breach. One (CICA) commented that communication to the audit committee chair might be appropriate for less significant breaches.

Six respondents expressed support for the position that those charged with governance should be permitted to establish a threshold below which insignificant breaches were not communicated. For example:

- There may be circumstances where it is appropriate for a firm to not be required to communicate certain breaches to those charged with governance. Those charged with governance at the client and the firm could exercise professional judgment to establish a protocol for the reporting of certain breaches. Those charged with governance may determine that they do not wish to be notified of trivial and inconsequential breaches that have little or no bearing on the firm's objectivity. (AICPA)

13 respondents expressed support for the position that breaches that were not significant need not be communicated to those charged with governance. Illustrative comments include:

- We would strenuously support an addition to the proposed sections concerning communication with those charged with governance, to require an assessment of the significance of a breach before determining the need to communicate. (ACCA);
- For this, we propose that the threshold of being material to the financial statements be established to ensure that significant breaches are subject to the required communication and documentation but that those that are clearly trivial are not accorded the same treatment. (FEE)
- We believe that another reasonable basis for determining the threshold for reporting breaches is the approach adopted in the existing Australian Code to document and communicate with those charged with governance those inadvertent violations that are not *trivial and inconsequential*. (APESB)

Three respondents (NASBA, ICPAR and IOSCO) commented on reporting a breach to a regulator. NASBA indicated that in some cases a firm may wish to communicate with a regulator regarding the breach and seek the views of the regulator whether appropriate actions can be taken to ensure that the firm's objectivity has not been compromised. ICPAR stated that the threshold for reporting should be to the relevant regulators.

ISOCO stated that "We believe that the Code should also go one step further in calling for the audit firm to promptly report the breach to regulators (or absent a regulator to

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the professional bodies overseeing the profession) and/or to investors if such reporting is encouraged in the jurisdiction, even though it is not required. Including this requirement in the Code would make provision for the audit firm to handle the breach in the paramount manner.”

Six respondents did not support the requirement that breaches be communicated “as soon as possible” and expressed the view that “on a timely basis” or “as soon as practicable” were more appropriate. Illustrative comments include:

- We believe that the proposed provisions should provide flexibility in the timing of communications based on the significance of the breach similar to the guidance contained in ISA 260 and that the communication should be “timely” rather than “as soon as possible”. (ASSIREVI)
- ISA 260 requires matters to be communicated “timely” and we believe this allows those charged with governance the necessary flexibility in determining protocols appropriate for such communications. For this reason we urge the Board to reconsider the requirement that independence breaches be communicated “as soon as possible”. (E&Y)

The Task Force has considered all of the comments received and is of the view that the comments received do not support a change from the requirement to communicate all breaches to those charged with governance. The Task Force notes that many respondents expressed the view that communication of all breaches was necessary for transparency and several expressed the view that establishing a threshold for those breaches that need not be communicated would introduce a level of subjectivity.

The Task Force notes that, while the exposure draft did not ask a question on the timing of reporting, some respondents did question whether all breaches needed to be reported on the same time line. In addition, some respondents who felt that there should be a threshold below which breaches need not be reported also commented on the need for some consideration of significance.

In considering the diversity of responses, and the number of comments on whether all breaches should be reported and the timing of reporting the Task Force is considering whether it would be appropriate to continue to require communication of all breaches to those charged with governance but to permit the timing of the reporting of less significant breaches to be established by those charged with governance. The Task Force believes that such an approach might address the concerns expressed by many that insignificant breaches should not be reported while still maintaining the transparency others desire that all breaches be communicated to those charged with governance.

The Task Force considered whether reporting to a regulator should be required in those jurisdictions where reporting is not required but is encouraged. The Task Force is of the view that a regulator has the authority to require a firm to report independence breaches. The Task Force is of the view that if a regulator wished to require this, the regulator would pass such regulation. The Task Force is of the view, therefore, that it would be inappropriate for the Code to require reporting in jurisdictions where the regulator only encourages such reporting. The Task Force notes that the documentation requirements, which address all breaches, provides a record that can be reviewed by those who inspect audit engagements.



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**Action Requested**

IESBA members are asked whether they agree that all breaches should be communicated to those charged with governance.

IESBA members are asked for their views on whether the timing of the audit firm's communication should be permitted to be in accordance with a protocol established by those charged with governance.

IESBA members are asked for their views on whether the nature of the audit firm's communication should be permitted to be in accordance with a protocol established by those charged with governance, i.e. whether those charged with governance can establish a threshold for which breaches should be reported.

IESBA members are asked whether they agree that the Code should not require reporting to a regulator, absent their being a regulatory requirement to report.

*Question 4 Do respondents agree that a reasonable and informed third party test should be used in determining whether an action satisfactorily addresses the consequences of a breach of an independence requirement? If not, why not and what should the test be?*

All but four respondents to the exposure draft agreed that the reasonable and informed third party test should be used in determining whether an action satisfactorily addresses the consequence of a breach of an independence requirement. Illustrative comments include:

- This test is one that is already employed within the Code and, thus, is one that is familiar to the profession (and to other users of the Code). (CGA)
- We agree that the reasonable and informed third party test should be used in this context. While we recognise that the test is not a purely objective measure and is capable of some degree of interpretation, it is a widely used test within the profession (and is therefore reasonably well understood), and we know of no better test to substitute for it. (ICAA)

Four respondents did not support the approach. One respondent (AICPA) stated that it would be difficult for a firm to determine what a reasonable and informed third party would likely conclude to be an appropriate course of action for addressing a breach of the independence requirements, and the impact of that action on independence and objectivity. The respondent felt that it would be more appropriate to allow the use of the firm's professional judgment with agreement by those charged with governance, to determine whether the actions taken satisfactorily address the consequences of the breach such that the firm's objectivity would not be compromised. One respondent (CND-CEC) felt that an impartial opinion should be obtained from another professional accountant (not within the firm or a network firm) or from a lawyer. One respondent (KICPA) felt that the reasonable and informed third party test was

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appropriate in the general principles in the Code but was not necessary when considering breaches. One respondent (IOSCO) felt that the test should be based on the views of a reasonable and informed investor and not the auditor.

The Task Force has considered all of the comments received and is of the view that the test is appropriate. The Task Force notes that it is consistent with the remainder of the Code and the definition of independence in appearance.

#### **Action Requested**

IESBA members are asked whether they agree with the use of the reasonable and informed third party test for determining whether an action satisfactorily addresses the consequences of a breach of an independence requirement

#### *Those Charged with Governance*

Four respondents commented on those charged with governance. One respondent (DTT) noted that the definition of those charged with governance in the Code is not consistent with the definition in ISA 260 *Communication with Those Charged with Governance* (Agenda paper 2-B).

The Code defines those charged with governance as:

“Persons with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process.”

The Code currently states that “regular communication is encouraged between the firm and those charged with governance of the audit client regarding relationships and other matters that might, in the firm’s opinion, reasonably bear on independence.”¶290.28

The exposure draft builds on the existing requirements in the Code with respect to communication with those charged with governance which include:

- Mergers and acquisitions ¶290.34-35
- Inadvertent violations ¶290.39, ¶290.117, ¶290.133
- A factor in considering the threat created when a former member of the audit team or partner joins an audit client ¶290.136
- Discussion required when, as a result of a business combination, a former key audit partner is in an otherwise prohibited employment position with an audit client ¶290.141;
- When emergency bookkeeping or taxation services are provided ¶290.174 and ¶290.186; and
- When total fees from an audit client represent more than 15% of the total fees of the firm ¶290.222.

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ISA 260 defines those charged with governance as follows:

“Those charged with governance – The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager. For discussion of the diversity of governance structures, see paragraphs A1-A8.”

Three respondents (CARB, CICA and KPMG) expressed the view that communication to the audit committee chair might be appropriate in some circumstances.

The Task Force has considered the comments received and, while it recognizes that the use of the phrase “those charged with governance” in the exposure draft is consistent with the remainder of the Code, it notes that the definition tends to point to the requirement to communicate breaches to the whole board of an entity, when it may in fact be more appropriate to report to the “audit committee” or even a delegate of the audit committee.

The Task Force also notes that the ISA contains guidance on the diversity of those charged with governance and how the auditor determines to whom to report (¶11-13 and A1-13). The Task Force is of the view that it would be appropriate to align the Code more closely to the ISA in this regard.

The ISA also contains requirements regarding communication of independence issues (¶17 and A21-A23) the IESBA staff will communicate the IESBA decisions regarding the treatment and communication of breaches to IAASB staff so that they can consider whether any conforming changes are necessary.

The Task Force recognizes that a revision to the definition of those charged with governance is outside the scope of this project and, as such, it is of the view that it should not be merely incorporated into the breaches project. However the Task Force is willing, if the Board so wishes, to take this on as a separate project. The Task Force is of the view that, in light of the limited scope of the project, undertaking this additional task would not impact the breaches timetable.

#### **Action Requested**

IESBA members are asked whether they are of the view the Code definition of “those charged with governance” should be aligned to the definition in ISA 260 and, if so, whether the breaches Task Force should undertake this activity.

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*Q5 Do respondents agree that the matters that should be discussed with those charged with governance as proposed in Section 290.46 are appropriate? If not, why not? Are there other matters that should be included, or matters that should be excluded?*

All but two respondents expressed general support for the matters that should be discussed with those charged with governance. One respondent (KICPA) expressed the view that the firm should be able to exercise judgment as to whether to discuss with those charged with governance. One respondent (IDW) stated that “we do not believe there is any merit in requiring the auditor to discuss with those charged with governance a “description of the firm’s relevant policies and procedures designed to provide it with reasonable assurance that independence is maintained” proposed in the third bullet point. As such policies and procedures are designed to provide reasonable but not 100% assurance, breaches may well occur. Thus breaches will not always indicate that the policies and procedures were at fault.”

Six of the respondents that expressed support for the approach noted that their support was subject to their comments that breaches that were not significant need not be communicated to those charged with governance and therefore that the less significant breaches should not be subject to the same documentation requirements. Six respondents provided some editorial and wording suggestions which will be considered at a future Task Force meeting.

Two respondents (WpK and FAOA) expressed the view that the list should not be seen as all-inclusive as there might be other matters that should be communicated in the particular circumstances.

One respondent (AAT) expressed the view that it might be helpful to add “to the list to ensure that the actions are fully undertaken would be an evaluation or review of actions undertaken to ensure that where a firm has agreed to undertake actions as described in bullet points 5 to 7, these are followed through within a measurable period of time to the satisfaction of those charged with governance.” The respondent noted that this implied by paragraph 290.47 but felt it might be useful to have an implicit requirement.

One respondent (CICA) stated that the list should also include the point that the firm should determine whether or not it should report the breach to someone else, including perhaps to a regulator such as a Securities Commission or a body having oversight of the professional accountant. The firm would then discuss its recommendation about reporting the breach to a relevant regulator with those charged with governance. This respondent also felt that the communication should be in writing.

Two respondents suggested changes to the third bullet of 290.46 to refer to the engagement period. One (IOSCO) suggested “...reasonable assurance that independence is maintained and will be maintained during the engagement period and the period covered by the financial statements.” One (IRBA) suggested reasonable assurance that independence is maintained, and will be maintained during the

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remainder of the engagement period and the period covered by the financial statements on which the report is issued”

One respondent (IOSCO) the discussion include the implications of the firm’s independence being breached and relevant regulatory requirements.

**Action requested**

IESBA members are asked to consider the suggestions for paragraph 290.46.

*Other Matters*

In reviewing the detailed comments received, the Task Force has identified some issues, which while not of the same significance as noted above, it would like to bring to the attention of the IESBA. The Task Force intends, subject to any input received by the IESBA, to consider these issues in re-drafting:

- Interaction of paragraphs 290.40, 290.46 and 290.47. Some respondents are reading these three paragraphs as meaning that as soon as a breach is identified the audit work must cease and the firm may only “continue with the audit engagement” once those charge with governance agree that action can be taken to satisfactorily address the consequences of the breach. The Task Force does not believe this was the intent of the exposure draft – while the interest or relationship that caused the breach is to be terminated, suspended or eliminated (¶290.40), it was not the intent to immediately suspend the audit. Some respondents are also reading 290.40 as being a separate communication requirement to that in 290.46, prior to the firm having had the chance to evaluate the breach or its significance. The Taskforce does not believe this was the intent of the exposure draft.
- Definition of a breach – There seems to be some confusion on what constitutes a breach of a requirement of the Code. The confusion could have arisen because the exposure draft specifically addresses a “requirement”. ¶100.4 states “The use of the word “shall” in this Code imposes a requirement on the professional accountant or firm to comply with the specific provision in which “shall” has been used. Compliance is required unless an exception is permitted by this Code.”

The Code contains absolute requirements (None of the following shall have a direct financial interest or a material indirect financial interest in the client: a member of the audit team; a member of that individual’s immediate family; or the firm. ¶290.104). It also contains a requirement to evaluate threats and apply safeguards to eliminate or reduce the threat to an acceptable level.

The Task Force is of the view that there could be a breach in either of circumstances described above. For example ¶290.131 states that a threat is created when a member of the audit team has a close relationship with a person, who is not a close or immediate family member, who is a director or officer of the audit client, or in a particular employment position. The paragraph requires a member of the audit team who has such a relationship to

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consult in accordance with firm policies and procedures. The paragraph then requires the evaluation of threats and application of safeguards when necessary. The Task Force is of the view if that if a member of the team did not consult (and therefore the relationship was not identified) and had the relationship been disclosed safeguards would have been necessary – this would constitute a breach of a requirement of the Code because, for a period of time, there was a threat to independence that was not at an acceptable level.

### **Next Steps**

The CAG meets on March 5, 2012. These agenda papers have been included in the CAG materials and the decisions of the IESBA will be presented at the CAG meeting. The Task Force has scheduled two meetings on April 1-2, 2012, and May 3-4, 2012 to discuss the input from the IESBA and CAG members.

Subject to comments from IESBA and CAG members, the Task Force anticipates presenting revised wording at the June 2012 IESBA meeting, together with a detailed cut and paste of all comments received.

### **Material Presented**

Agenda Paper 2	This Agenda Paper
Agenda Paper 2-A	Exposure Draft
Agenda Paper 2-B	ISA 260 Communications with those Charged with Governance

### **Action Requested**

1. IESBA members are asked to address the questions set out in the agenda paper.

<b>LIST OF RESPONDENTS</b> <i>Proposed Changes to the Code of Ethics for Professional Accountants Related to Provisions Addressing a Breach of a Requirement of the Code</i> <b>Due: January 23, 2012</b>		
<b>ABBR.</b>	<b>ORG.</b>	<b>#</b>
<b>MEMBER BODY</b>		
AAT	Association of Accounting Technicians	1
ACCA	The Association of Chartered Certified Accountants	1
AIA	The Association of International Accountants	1
AICPA	American Institute of CPA	1
CGA	Certified General Accountants Association of Canada	1
CICA	The Canadian Institute of Chartered Accountants	1
CICPA	Chinese Institute of Certified Public Accountants	1
CNCC-CSOEC	Compagnie Nationale des Commissaires aux Comptes + Conseil Supérieur de l'Ordre des Experts-Comptables	1
CND-CEC	Consiglio Nazionale dei Dottori Commercialisti + E Degli Esperti Contabili	1
CPA Au	CPA Australia	1
FAR	FAR	1
FSR	Foreningen af Statsautoriserede Revisorer	1
HKICPA	Hong Kong Institute of Certified Public Accountants	1
ICAA	The Institute of Chartered Accountants in Australia	1
ICAEW	The Institute of Chartered Accountants in England and Wales	1
ICAS	The Institute of Chartered Accountants of Scotland	1
ICJCE	Instituto de Censores Jurados de Cuentas de España	1
ICPAR	INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANT OF RWANDA	1
ICPAS	Institute of Certified Public Accountants of Singapore	1
IDW	Institut der Wirtschaftsprüfer	1
JICPA	The Japanese Institute of Certified Public Accountants	1
KICPA	Korean Institute of Certified Public Accountants	1
MIA	Malaysian Institute of Accountants	1
NASBA	National Association of State Boards of Accountancy	1
SAICA	The South African Institute of Chartered Accountants	1
WPK	Wirtschaftsprüferkammer	1
<b>FIRMS</b>		
BDO	BDO Global Coordination B.V.	1
DTT	Deloitte Touche Tohmatsu	1
EYG	Ernst & Young Global	1
GT	Grant Thornton International	1
KPMG	KPMG	1
Mazars & Guérard	Mazars and Guérard	1
PwC	PricewaterhouseCoopers	1
<b>REGULATORS &amp; PUBLIC AUTHORITIES</b>		
CARB	Chartered Accountants Regulatory Board	1
CPAB	Canadian Public Accountability Board	1
IOSCO	International Organization of Securities Commissions	1
IRBA	Independent Regulatory Board for Auditors	1
<b>INDIVIDUALS &amp; OTHERS</b>		
<b>OTHER PROFESSIONAL ORGANIZATIONS</b>		
APESB	Accounting Professional & Ethical Standards Board Limited-Australia	1
ASSIREVI	ASSIREVI - Italy	1
Auditor-General, NZ	Office of the Auditor-General of New Zealand	1
FAOA	Federal Audit Oversight Authority	1
FEE	Fédération des Experts Comptables Européens	1
NZAuASB	New Zealand Auditing and Assurance Standards Board	1
<b>TOTAL RESPONSES</b>		<b>43</b>