Breaches Feedback Statement on March 2011 CAG Comments

CAG Member Comment	Task Force Consideration
Mr. Hansen noted that in the presentation and also the papers there was a lot of focus on the difficulties a company might face if its auditor had to resign.	The first paragraph of the section (290.39) now indicates that a consequence of the breach may be that termination is necessary. Also additional prominence given to the need to consider whether resignation is appropriate
Mr. Morris expressed the view that the Code should describe actions to be taken when there is a violation but it was important that the guidance be written in such a way that it does not encourage noncompliance – the presumption should be that compliance is mandatory. The drafting of the current Code does sound a little permissive and implies a bit of a "free pass" mentality. He noted that the Code should address the steps to be taken, including discussion with those charged with governance and possibly the regulator. Mr. Fleck noted that one of the challenges with the existing Code is that it does not address responsibility – if responsibility was addressed it would be easier to indicate the actions to be taken to address a violation.	Paragraphs redrafted to provide more prominence to need to consider resignation, as noted above. Paragraph 290.46 provides detailed guidance on matters to be discussed with those charged with governance.
Mr. James stated that he did not see the need for provisions to address an inadvertent violation because each section of the Code has an inbuilt way of dealing with a violation.	Paragraphs 290.116 and 291.11 contain provisions to address a breach that would be created if a financial interest was obtained through inheritance, gift or merger. The paragraphs do not address a breach that would be created if a person purchased a prohibited financial interest.
Mr. Koktvedgaard stated audit regulators would examine violations when they performed their review of audit firms. It was, therefore, important to link to audit regulators. He also questioned what public communication should take place – for example, should the auditor give a public report on the violation, the steps that were taken after the violation, and why the firm believes that it is still independent? Mr. Baumann noted that communication to the public was an interesting notion as some would like to see a statement in the audit report that the auditor is not independent. There may also be some who would	The IESBA is of the view that there needs to be a regulatory framework to receive the disclosure of a breach. The IESBA is aware of one jurisdiction that requires public disclosure of certain breaches but the majority of jurisdictions do not have it.

want to see a public disclosure of a violation.	
Mr. Fleck stated that he was conscious of the challenges that arise if a regulator will not give clearance on a minor violation. In such circumstances the only way to address a minor violation is to have an open dialogue between the firm and the audit committee.	The proposed guidance would require a detailed discussion with those charged with governance (290.46)
Mr. Baumann stated that there should probably be an expectation that significant matters would be communicated to a regulator.	Paragraph 290.41 requires the firm to comply with any regulatory requirements, which would include reporting a breach to a regulator when required.
The IESBA CAG discussed the Task Force recommendation and, while broadly agreeing with the actions to be taken, provided the following direction to the Task Force: • All violations should be disclosed to those charged with governance irrespective of magnitude or who committed the violation;	The proposed guidance would require all violations to be disclosed to those charged with governance
• It was not clear what was meant by "resolve the situation";	The phrase has been deleted and replace with the concept of whether there are "actions that satisfactorily address the situation" and a reasonable observer test has been added
• The drafting should not imply that all violations could be rectified such that the audit could continue. It may be useful to make it clear that in some cases resignation may be necessary; and • The drafting should not convey the impression that the aim is to continue the audit at all costs and it may be preferable for the drafting to expressly state that resignation would be necessary unless certain conditions could be met.	Proposed guidance emphasizes the need to determine whether resignation is necessary.
Ms. Blomme stated that she agreed with the framework proposed but noted it might be useful to be clearer about the conditions that need to be in place such as prompt correction and application of necessary safeguards.	Proposed guidance states that steps should be taken as soon as possible to suspend or eliminate the breach (290.40), it would require a detailed discussion with those charged with governance (290.46) and

	agreement from those charged with governance (290.47).
Mr. Morris noted that it might be useful to split the guidance to separately address the actions to be taken to determine whether the firm can continue as auditor and the actions to be taken regarding the individual who caused the violation.	The IESBA discussed this matter and formed the view that the guidance in the Code should address how a firm should address the consequences of a breach. While knowledge of the interest or relationship that caused the breach is a factor that would affect the significance of the breach, the role of the Code does not address disciplinary matters.
Mr. James indicated that IOSCO would want to consider whether, if every violation was not going to be discussed, there should be a distinction between whether the violation was inadvertent or not.	The proposed guidance would require all breaches to be discussed with those charged with governance.
Mr. Kuramochi stated in thinking about the significance of a violation it was important to consider the aggregate effect of any violations. Several insignificant violations could be indicative of a more significant underlying problem that needed to be addressed.	The requirements to discuss all breaches (regardless of magnitude) and any steps to reduce or avoid the risk of recurrence would implicitly require the need to consider the aggregate effect of any violation.
Ms. de Beer expressed the view that if there were to be a *de minimis* test, where reporting was not necessary, it would be important that the wording clearly convey the fact that the threshold is at a very low level. Mr. Fleck indicated that in setting the threshold it would be important to consider the relationship between the violation and the effectiveness of the firm's systems of control.	Not applicable – all breaches to be discussed with those charged with governance
Mr. Pannier stated that a *de minimis* threshold would provide a pragmatic approach. He expressed support for the direction of the proposal noting that it was important that violations were dealt with in an appropriate manner. Mr. Johnson noted that the discussion was similar to the debate regarding reporting of internal control weaknesses. It is a difficult issue to know where to establish a threshold because of the concern that small issues might be indicative of a larger more systemic problem. He noted that there will be some audit	IESBA is of the view that all breaches should be discussed with those charged with governance.

committee chairs who will want every violation reported and others that only want to see any matter of significance. Mr. Koktvedgaard stated that if the notion of inadvertent is to be dropped, there should not be a *de minimis* threshold. A threshold would also disincentivize firms from having robust systems of quality control. Mr. Hansen stated that he thought audit committees would likely want to hear about all violations.	
Mr. Pickeur said that in addition to knowing how the violation occurred it was important to know how it was detected. In this regard the firm should disclose to the audit committee how it monitors independence. Mr. Johnson noted that there is a requirement under auditing standards for auditors to state that they are independent. In Europe there is also a requirement to have a public document regarding independence and quality control. Mr. Hansen agreed with Mr. Pickeur that it was important to disclose how the matter was detected and how independence is monitored.	Paragraph 290.46 requires the firm to provide those charged with governance a description of the firm's independence policies and procedures designed to provide it with reasonable assurance that independence is maintained.
Mr. Fleck stated that he would like to provide the CAG with an opportunity to comment on the next draft before it went to the IESBA for approval as an exposure draft. He noted that he would work with Mr. Dakdduk and Ms. Munro to see how this could be achieved.	Draft circulated to CAG members prior to the IESBA Prague Meeting.