Draft Minutes of the Meeting of the
International Ethics Standards Board for Accountants
June 15, 17, 2011
Warsaw, Poland

	Members	**Technical Advisors**
Present:	Ken Dakdduk	
	Robert Franchini	Sylvie Soulier
	James Gaa	Stephen Spector
	Caroline Gardner (Day 2 and 3)	
	Jörgen Holmquist	
	Peter Hughes	
	Felicitas Irungu (Day 1 in part, Day 2 and Day 3)	
	Wui San Kwok	Andrew Pinkney
	Alice McCleary	Eva Tsahuridu
	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
	Nina Barakzai	
	Caroline Gardner	
Regrets	Lisa Snyder	
	Non-Voting Observers	
Present:	Richard Fleck	
Regrets	Juan Maria Arteagoitia	
	Koichiro Kuramochi	
	PIOB	

Present Gonzalo Ramos

IFAC Technical Staff

Present: Jan Munro

Guests

Present: Jason Evans Item 3

1. Introduction and Administrative Matters

Minutes of the Previous Meeting
The minutes of the February 2011 IESBA meeting were approved as presented subject to some editorial revisions.

Mr. Dakdduk provided an update on activities since the February IESBA Meeting.

CAG
The IESBA CAG met in New York on March 7, 2011. The main items on the agenda were the IESBA projects addressing Conflicts of Interest, Responding to a Suspected Illegal Act, and a Breach of an Independence Provision of the Code. The Task Forces addressing these projects have carefully considered the CAG members' comments.

SMP Forum
The IFAC SMP Committee held a forum in Istanbul, Turkey on March 21, 2011. Mr. Thomson, SMP Working Group Chair, and other members of the working group participated in this forum and the chair lead a panel discussion to solicit input on the challenges faced by professional accountants in SMPs and SMEs in complying with the Code.

IESBA – National Standard Setters (IESBA-NSS)
The third annual IESBA-NSS meeting took place in Toronto, Canada on April 27, 2011. Approximately thirteen countries were present and the main items on the agenda were the IESBA projects addressing Conflicts of Interest, Responding to a Suspected Illegal Act, and a Breach of an Independence Provision of the Code. The Task Forces have considered comments received.

New IAASB Project – Audit Quality
The IAASB has commenced a new project to define and provide guidance on achieving audit quality. Mr. Thomson has agreed to be the IESBA liaison on the project and the IESBA can expect updates on this project as it progresses.

PIOB

Mr. Dakdduk reported that there had been some changes at the PIOB and invited Mr. Ramos to provide the IESBA with an overview of the changes. Mr. Ramos thanked Mr. Dakdduk and stated that he was pleased to be observing the IESBA meeting on behalf of the PIOB. He provided an update on the change in membership, including the new chair Eddy Wymeerch.

He noted that one of the Monitoring Group recommendations addressed the PIOB 100% observation model for PIAC meetings. The Monitoring Group raised the question as to whether it was necessary for the PIOB to continue the 100% observation policy. The PIOB is discussing what changes might be necessary in the future. It is likely that there will be less than 100% observation by Board members and some room for staff to observe the PIAC meetings.

2. Breach of an Independence Requirement

Ms. Spargo introduced the project. At its February 2011 meeting, the IESBA discussed and provided input on the proposals of the Task Force to reconsider the paragraphs that address an inadvertent violation of a provision of the Code. The proposals and IESBA input were discussed by the CAG at its March 2011 meeting and by the IESBA-National Standard Setters (IESBA-NSS) at its meeting in April 2011. The Task Force met on April 9-10, 2011 and May 7-8, 2011 and by conference call on May 30, 2011 to consider the feedback received and to develop proposed wording for the exposure draft.

At the February meeting, the Task Force proposed, and the IESBA agreed, that:

- The Code should contain provisions to address a violation of a requirement;
- The provisions should address only independence requirements, because without such guidance users of the Code could assume that the intention is that any violation should result in the firm's resignation, regardless of the magnitude of the violation, which may not be in the public interest; and
- The cause of the violation, intentional or inadvertent, is less significant that the potential impact on the company and consequently those affected. It is the violation that gives rise to the issue, regardless of its nature. The term "inadvertent" should, therefore, be dropped.

At the March CAG meeting, CAG members expressed different views with respect to the need for such provisions. Some CAG members agreed with the IESBA's view that the Code should contain such provisions; others felt that the Code should not contain such provisions, noting that regulators would have processes to deal with such matters. With respect to dealing with all types of violations, those CAG members who expressed support for the Code containing such provisions agreed that the provisions should address only independence violations.

All IESBA-NSS participants agreed with the IESBA view that the Code should address such matters, it should be limited to independence violations, and the reference to inadvertent should be removed.

Violation vs Breach
Ms. Spargo reported that the Task Force has considered whether the matter should be referred to as a "violation." The Task Force noted that the Code currently uses the term "violation" when discussing an inadvertent violation of a provision of the Code but in other instances the Code refers to a breach. The Task Force is of the view that "breach" is a better description and would improve the consistency of terminology within the Code. It has, therefore, adopted this term.

The IESBA discussed and agreed with the Task Force's recommendation to reference a "breach" as opposed to a "violation."

Actions to be Taken
Ms. Spargo reported that the IESBA had provided the following direction to the Task Force at its February 2011 meeting:

- All violations should be disclosed to those charged with governance, irrespective of magnitude or who committed the violation;
- It was not clear what was meant by "resolve the situation";
- 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;
- 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.

She noted that several of these comments were echoed by CAG members and IESBA-NSS participants who noted that:

- Establishing a *de minimis* threshold below which reporting to those charged with governance was not necessary might discourage firms from establishing robust systems of internal control;
- The drafting should not imply that irrespective of the violation, the firm could always continue the audit;
- Those charged with governance would want to know how the violation occurred; and
- It should be very clear that if there is a regulatory mechanism for reporting and resolving such matters, this should take precedence.

The Task Force carefully considered all the input from the IESBA, CAG members, and IESBA-NSS participants, and has revised the drafting to address the comments as follows:

- Developing an introductory paragraph explicitly stating that it may be necessary to terminate the audit engagement and also stating that reporting to a regulator or other body might be required;
- Requiring the auditor to discuss all breaches with those charged with governance;
- Requiring the firm to evaluate the significance of the breach, its impact on the firm's objectivity and ability to issue an audit report;
- Eliminating the phrase "resolve the situation" and introducing a requirement for

> the firm to determine whether action can be taken to address the consequences of the breach and requiring the firm to exercise professional judgment, taking into account whether a reasonable and informed third party, weighing the significance of the breach and the action to be taken, would be likely to conclude that the firm can still issue an audit opinion;

The Task Force has also developed a paragraph addressing a breach that occurred prior to the issuance of the previous audit opinion.

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

- The logic and flow of the paragraphs would be improved if paragraphs 44 and 45 were reversed; and
- The tone of the drafting seems to imply that the firm can continue as auditor if the firm determines that this is appropriate. In reality, those charged with governance have to be in agreement. While this might be implicit in the drafting, it would be preferable to make it explicit.

Timing of Discussing a Breach

The IESBA considered the timing of discussing a breach with those charged with governance. The Task Force proposal was that the discussion be "on a timely basis." Ms. Spargo reported that the Task Force had considered other timing and had concluded that timely was appropriate because it was contextual – a significant breach would be discussed more quickly than a minor, technical breach. The IESBA made the following comments:

- It might not be clear that "timely" was contextual, especially when translated;
- Timely discussion with those charged with governance is a new concept in the Code; and
- Perhaps the timing of the discussion should be linked to the materiality of the breach – for example, if the breach was such that it might change the decision of those charged with governance, it would be discussed immediately; if it would not change the decision, later discussion would be acceptable.

The IESBA discussed three alternatives:

- Discussion on a timely basis;
- Discussion as soon as possible; and
- Discussion as soon as the firm has completed its analysis of the situation.

After discussion, the IESBA concluded that the discussion should be as soon as possible.

Discussion of all Breaches

It was noted that the Task Force proposals removed the "safe harbor" provisions of not discussing certain personal financial breaches. It was noted that, at the February IESBA meeting, the IESBA had determined that all breaches should be discussed with those charged with governance, irrespective of magnitude or who committed the violation. This position had been discussed with the CAG and CAG members had agreed that all breaches should be discussed with those charged with governance. If there was a series of trivial breaches this might be indicative of a systemic problem. It was also noted at the

IESBA-NSS meeting that if there is to be a judgment about whether a matter was trivial, it should be made by those charged with governance and not the firm.

It was noted that paragraph 290.28 encourages communication "regarding relationships and other matters that might, in the firm's opinion, reasonably bear on independence." It was suggested that discussion of breaches be linked more closely to this paragraph. An alternative view was expressed that doing so was not necessary because if there is a breach the auditor is not independent, therefore every breach would "reasonably bear on independence."

A view was expressed that requiring the discussion of all breaches might impose an obligation on those charged with governance to discuss minor matters. An alternative view was expressed that transparency and disclosure were important and, if a breach was a minor matter, it would not be time consuming for those charged with governance to consider the matter. It was also noted that the SEC independence requirements related to financial interests are considerably more detailed than those in the Code and, as such there could be a larger number of breaches, thus supporting the need for some safe harbor provisions for SEC requirements.

The IESBA concluded that the Task Force proposal to discuss all breaches with those charged with governance was appropriate.

Review of Drafting Paragraph by Paragraph
Ms. Spargo led the IESBA through the proposed drafting and the following points were noted:

Paragraph 290.40

- This paragraph should also refer to suspending the activity that caused the breach because it might not be possible to quickly eliminate the breach but action could be taken to suspend the related activity so that the situation is not exacerbated;
- The examples should be presented as examples and should not, therefore, contain any shall statements;
- The second bullet reference to restructuring a non-assurance service so that it was no longer prohibited conveyed the wrong impression and should be deleted

Paragraph 290.41

- The meaning of the last bullet was not clear and it might be better to refer to the impact of the non-assurance service on the accounting records or financial statements.

Paragraph 290.42

- The proposal was worded in the positive, that is, "whether a reasonable and informed third party, weighing the significance of the breach and the action to be taken, would be likely to conclude that the firm can still issue an audit opinion." It might be a more robust test to word it in the negative, that is, whether the third party would be likely to conclude that the firm cannot issue the audit opinion.
- The reference should be to an "audit report" and not an "audit opinion."

Paragraph 290.43

- The third bullet refers to "engaging another firm to review or re-perform." It should be clear from the drafting that it is the client that should engage the other firm.

Paragraphs 290.44 and 290.46

- If paragraph 290.45 was moved before 290.44, paragraphs 290.44 and 290.46 should be combined.
- The requirement to disclosure any disciplinary action the firm has taken or proposes to take seems to imply that the firm will always take disciplinary action. Depending on the nature of the breach and how it occurred, this would not always be the case.
- There are two separate issues: actions to be taken to address the existing breach; and remedial actions including disciplinary action – those charged with governance have an interest in the former but not the latter. An alternative view was expressed that those charged with governance would have interest in these matters because it would be indicative of how seriously the firm had taken the breach.
- Any discussion of disciplinary action should not be linked to whether the firm is able to issue an audit opinion, because the two matters are not related.
- A concern was expressed that, as drafted, paragraph 290.46 could be read as meaning that those charged with governance have to agree with the disciplinary to be taken.
- It was noted that ISQC1 contains detailed requirements regarding recommendations for remedial action regarding identified deficiencies in the firm's quality control policies and procedures. It includes disciplinary action against those who fail to comply with the policies and procedures of the firm.
- There is no requirement for the firm to put in place any actions requested by those charged with governance.
- In some jurisdictions, the firm cannot decide on its own to terminate the audit engagement. It would, therefore, be better if the reference was in the passive.

Paragraph 290.47

- A view was expressed that this paragraph was not necessary because the fundamental principle of professional behavior requires a professional accountant to comply with relevant laws and regulations. An alternative view was expressed that the section should be explicit. The IESBA agreed with this alternative view and also stated that the paragraph should be moved up in the section to make it clear that nothing in the section overrode a legislative requirement.

Section 291

The IESBA discussed the approach taken in drafting the proposed paragraphs for Section 291. The following points were noted:

- While the approach taken had been to mirror Section 290, this might not be appropriate because in many Section 291 engagements, the firm would not have access to those charged with governance;

- The approach for Section 291 should be the same as proposed for Section 290 but at a more principled level.

On the third day of the meeting, the IEBSA reviewed a draft of the proposed wording, revised to reflect the comments above and the following points were noted:

- It should be clear that it is the audit client that would engage another firm to review or re-perform the affected work; and
- In some cases it seems as if the guidance is directed to those charged with governance. In this regard it would be preferable for 290.47 to refer to those charged with governance "agreeing" that the firm may continue the engagement as opposed to "concluding."

Ms. Spargo thanked the IESBA for its input, which would be carefully considered by the Task Force.

3. Conflicts of Interest

Mr. Niehues introduced the topic. He reported that the Task Force met twice to consider the description of a conflict of interest along with the wording of the drafts of Sections 220 and 310. Mr. Niehues also explained that the Task Force was in the process of developing an impact analysis of the project.

Description of a Conflict of Interest

Mr. Niehues reported that the Task Force considered creating a definition of the phrase "conflict of interest" for inclusion in the definition section of the Code. However, the Task Force decided that a definition of "conflict of interest" in the definition section is not necessary due to the fact that terms in the definition section of the Code are used throughout the entire Code, and the description developed by the Task Force is specific to Sections 220 and 310.

Mr. Niehues reported that the Task Force considered the description of a conflict of interest as presented to the Board at the February 2011 meeting. Specifically, the Board had concerns with the phrase "other than with that party." Mr. Niehues noted that there were no questions from the Board regarding the two bullet points within the description and that the bullet points clearly state the relationships that could cause a conflict of interest. Therefore, the Task Force agreed to modify the first sentence, while keeping the aspects of a conflict of interest beginning with the undertaking of a professional activity and the link to the fundamental principles. However, the modifications to the description create a focus on the bullet points in order to describe a conflict of interest. The proposed new description is as follows:

> *A professional accountant may be faced with a conflict of interest when undertaking a professional activity. A conflict of interest creates a threat to objectivity and may create a threat to other fundamental principles. Such threats may include:*
>
> - *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.*

The Board generally agreed with the change. However, one observer expressed the view that the threat that is caused by a conflict of interest is not only to objectivity, but also the professional accountant's ability to represent and serve the client.

Reasonable and Informed Third Party Test
Mr. Niehues reported that Task Force reconsidered the language in the reasonable and informed third party test based on the feedback from the Board. The Task Force re-drafted the language to state that the professional accountant shall consider the views of a reasonable and informed third party when identifying, evaluating, and managing a conflict of interest.

The Board generally agreed with the proposed paragraph, however, one Board member noted that the word "not" in the phrase "…fundamental principles is not compromised" places a burden of proof on the professional accountant to prove that there is not a conflict of interest and suggested removing the word "not." The Task Force agreed to consider the suggestion.

Network Firms
Mr. Niehues reported that based on feedback from the Board at the February 2011 meeting, the guidance concerning network firms was moved from a standalone paragraph to a bullet point in paragraph 220.5. Mr. Niehues also stated that the Task Force reconsidered the previous proposal that a firm within a network should evaluate a potential conflict of interest when it has reason to believe one may exist based on the interests and relationships a client has with another network firm. The Task Force believed this should remain as the standard, as threats relating to conflicts of interest should be evaluated consistently with that of threats to independence when providing non-audit assurance services based on paragraph 291.3 of the Code. Some members of the Board believed this threshold to be too low and some felt it was acceptable; however, more guidance was needed on how to meet this obligation. It was also suggested that the Task Force should consider a documentation standard for firms when evaluating potential conflicts of interest that involve other firms in a network. The Task Force agreed to reconsider the guidance.

Inclusion of the Term "Firm" within Section 220
Mr. Niehues reported that the Task Force agreed to use the phrase "professional accountant in public practice, including the firm" when referencing the professional accountant in public practice for the first time within each paragraph in Section 220 and then mentioning only the "professional accountant in public practice" each time after within the respective paragraph. The term "professional accountant in public practice" already includes the firm by definition; however, this decision was intended to emphasize that the professional accountant should consider the entire firm when identifying conflicts of interest. However, the Board agreed that there should be no mention of the firm based

on the definition of a professional accountant in public practice and due to the fact that including the term "firm" in some areas of the Code and not in others may be confusing.

Situations Where Disclosure May Not Be Possible
Mr. Niehues reported that the Task Force drafted a paragraph in Section 220 providing guidance on situations where a perceived conflict of interest may not be disclosed due to a potential breach of confidentiality and/or due to the timing of the service. This may occur when a firm has two clients and a new engagement with respect to one client may be opposed to the interests of another; for example, during a hostile takeover or when the firm is required to perform such a service as directed by a regulator. Disclosure of this type of service may normally be required; however, if institutional mechanisms are in place and confidentiality is not breached, it may serve the public interest for the firm to proceed with the service. The Board provided the following feedback:

- While these situations may occur, the language should be more strict so that firms will not use this guidance as reason to not disclose a potential conflict of interest:
- The services provided in these situations should be limited to the firm providing factual data that already exists and the services should not be of an adversarial nature; and,
- The proposed guidance is too lengthy to describe a narrow situation that does not occur frequently, which possibly over stresses the point.

The Task Force agreed to reexamine the guidance based on the feedback from the Board.

Compensation and Financial Reporting
Mr. Niehues reported that the Task Force, as directed by the Board, considered Sections 320, *Preparation and Financial Reporting*, and 340, *Financial Interests*, to further examine situations where financial reporting is linked to compensation. The Task Force concluded that it would be beneficial to have a cross reference from Section 310 to the respective sections for professional accountants in business who may seek guidance on these situations in Section 310. Also, the Task Force recommended that Sections 320 and 340 should be re-named to better reflect the guidance within to: "Preparation and Reporting of Information and Undue Pressure" and "Compensation and Incentives Linked to Financial Reporting and Decision Making," respectively.

The Board believed that if Sections 320 and 340 were not reviewed in detail to propose any potential changes, then the titles of the sections should not be changed. The Board requested that the Task Force consider examining the sections in detail and recommend whether the current Task Force should develop further guidance for each section.

Mr. Niehues thanked the IESBA for its input and noted that all the points would be carefully considered by the Task Force.

4. Responding to a Suspected Fraud or Illegal Act
Mr. Franchini introduced the project. At its February 2011 meeting, the IESBA discussed and provided input on the proposals of the Task Force to develop guidance for

professional accountants on how to respond to a suspected illegal act. The proposals and IESBA input were discussed with the CAG at its March 2011 meeting and with the IESBA-NSS at its meeting in April 2011. The Task Force met briefly after the IESBA meeting in Delhi, and on April 19-20, 2011 and May 16-17, 2011 to consider the feedback received and develop proposed wording for the exposure draft.

Nature of Items to be Addressed
At the February meeting, the Task Force proposed that the guidance focus on frauds and illegal acts that have a direct or indirect effect on the financial reporting of the client or employing organization. The IESBA felt that restricting the scope of the guidance in this manner might be too limiting. It was also noted that a discussion of the nature of the 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 Task Force considered this matter and agreed with the approach. In considering the difference between a fraud and an illegal act, the Task Force recognized that a fraud is an illegal act. The Task Force determined, therefore, that the section should address suspected illegal acts. Paragraphs 225.2 and 360.2 contain examples of illegal acts and the first two examples address fraud.

The previous Task Force proposals also addressed unethical or improper acts. It was noted at the February 2011 IESBA meeting that unethical or improper behavior is a somewhat nebulous matter and it is difficult to define – what might be considered ethical today might be considered unethical in five years time. Also what might be seen as ethical in one jurisdiction might be viewed as unethical in another jurisdiction. It was also noted that if a matter is deemed to be unethical but not illegal, requiring an accountant to breach confidentiality and report the matter outside of the client or employing organization could be a very onerous requirement. CAG members raised similar comments noting that while it is possible to define a fraud or an illegal act, there is considerably more subjectivity associated with determining whether something is improper or unethical.

The Task Force considered this feedback with the view to determining whether the proposed sections should address acts that the professional accountant determines to be unethical or improper. The Task Force was mindful that there is no accepted definition of an unethical act and what would be considered to be unethical by one professional accountant may not be considered to be unethical by another professional accountant. In addition there is no accepted framework for determining whether a matter is unethical. While the determination of whether a matter is illegal can be judgmental, and may differ from jurisdiction to jurisdiction, there is a legal framework for assessing whether a matter is illegal. There are also issues with determining the appropriate authority to whom to report a suspected unethical act. Even if there is an appropriate authority, it is questionable whether the authority would take action regarding a matter that was legal but considered to be unethical.

In light of this, the Task Force recommends that the proposed sections should not address unethical matters. The Task Force is of the view that the matter should be addressed in the section dealing with ethical conflict resolution. The guidance would be more appropriate in this section because if the professional accountant believes that a client or employing organization is engaging in an unethical act that is nonetheless legal, the accountant is facing an ethical conflict.

The Task Force also reviewed Section 210, for professional accountants in practice, and will be determining whether the guidance on client acceptance and continuance should be strengthened.

Section 210 addresses client acceptance. Paragraph 210.1 states:

> Before accepting a new client relationship, a professional accountant in public practice shall determine whether acceptance would create any threats to compliance with the fundamental principles. Potential threats to integrity or professional behavior may be created from, for example, questionable issues associated with the client (its owners, management or activities).

Paragraph 210.5 states:

> It is recommended that a professional accountant in public practice periodically review acceptance decisions for recurring client engagements.

With respect to professional accountants in business, paragraph 300.15 states:

> In circumstances where a professional accountant in business believes that unethical behavior or actions by others will continue to occur within the employing organization, the professional accountant in business may consider obtaining legal advice. In those extreme situations where all available safeguards have been exhausted and it is not possible to reduce the threat to an acceptable level, a professional accountant in business may conclude that it is appropriate to resign from the employing organization.

The Task Force's view is that this guidance is likely sufficient.

Process for Responding

In considering the thought process that the professional accountant would use in determining how to respond to a suspected illegal act, the Task Force developed the following sequential approach for disclosing within the client or employing organization before considering whether the matter should be disclosed outside:

- A professional accountant in public practice discloses the matter as follows:
  - To management at an appropriate level;
  - If the response to the matter is not appropriate, the professional accountant shall escalate the matter;

    - If the highest level of management has not appropriately responded to the matter, the professional accountant shall discuss the matter with those charged with governance.
- A professional accountant in business discloses the matter as follows:
    - Within the reporting lines of the organization, to a superior;
    - If the response to the matter is not appropriate, the professional accountant shall escalate the matter;
    - If the highest level of management has not appropriately responded to the matter, the professional accountant shall discuss the matter with those charged with governance or shall disclose the matter to the entity's external auditor.

The Task Force has also developed 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 remedial action has been taken to address the matter;
- Whether steps have been taken to reduce the risk of re-occurrence, such as additional controls or training; and
- Whether the entity has disclosed the matter to an appropriate authority, if any, or intends to do so within a reasonable period of time.

Actions to be taken after Disclosing within the Organization

At its February 2011 meeting, the IESBA agreed that disclosure shall be made to an appropriate authority when disclosure is in the public interest. CAG members and the IESBA-NSS members concurred with this.

The Task Force has considered whether guidance can be given on when reporting would be in the public interest. At the February 2011 IESBA meeting, the IESBA discussed the following factors that could be considered in determining whether disclosure was in the public interest:

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

The IESBA considered these factors and it was noted that

- 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; and
- With respect to the third factor 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.

The factors were discussed at the CAG meeting in March and similar comments were raised.

The Task Force has revisited these factors and recognizes that whether disclosure is in the public interest is a matter requiring professional judgment and it will ultimately be a decision that the individual professional accountant has to make. Different individuals may have differing thresholds for disclosure. In light of this and the fact that there is no common definition of the public interest, the Task Force is of the view that the sections should not describe factors that the professional accountant would consider in determining whether disclosure is in the public interest. The Task Force is concerned that factors might be seen as limiting. The Task Force is of the view that in making the determination, the professional accountant should take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances, would be likely to conclude that the public interest is best served by disclosing the matter to an appropriate authority. The disclosure would be made to an appropriate authority only after "having given the matter careful thought and having taken appropriate advice." In addition, the proposed guidance calls for the accountant to "act reasonably, in good faith and exercise caution when making statements and assertions."

Nature of Matters to be Disclosed
The Task Force considered the types of illegal acts that the professional accountant would be required to disclose to an appropriate authority. In considering this matter the Task Force considered the principle of confidentiality, which would be over-ridden because disclosure was in the public interest.

The Code describes the fundamental principle of confidentiality as follows:

> *Confidentiality* – 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.

In considering this principle, the Task Force noted that information is deemed to be confidential if it is "acquired as a result of professional and business relationships. The Task Force considered what types of suspect illegal acts would be identified through information that was acquired as a result of professional and business relationships. The Task Force is of the view that such illegal acts would be:

- Suspected illegal acts that directly or indirectly affect the client's/employing organization's financial reporting; and
- Suspected illegal acts the subject matter of which falls within the expertise of the professional accountant, such as fraud, bribery or insider trading.

Information regarding illegal acts that do not affect the financial reporting and that fall outside the expertise of the professional accountant would not be information that was acquired as a result of a professional and business relationship. This information would not, therefore, be deemed to be confidential – such as would be the case if the professional accountant obtained information about the personal conduct of management of a client. Accordingly, the Task Force is of the opinion that it is not necessary for the Code to address such matters.

Pre-requisites for Disclosure

At the February 2011 IESBA meeting, during the discussion of whether there were situations where a requirement to disclose might be disproportionate, a suggestion was made that the requirement to disclose should be conditional on the existence of the following conditions:

- Disclosure is not contrary to laws and regulations;
- A whistle-blowing protection scheme is in place that affords the whistle-blower both anonymity and protection from liability; and
- There is an appropriate authority to receive the disclosure and there is a judicial process that can be trusted.

This suggestion was discussed with the CAG at its meeting in March. CAG members expressed the view that whistle-blowing protection has not been sufficiently implemented to make this approach effective.

The Task Force has considered the conditions and is of the view that:

- The proposed guidance should stipulate that disclosure should be made to an appropriate authority; and
- The Code should not contain any statements regarding when disclosure would not be required because the consequences would be disproportionate, for example, because of personal safety. Such statements would be inappropriate and may be inappropriately applied.

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

- Whether it was appropriate that the requirements for professional accountants in business should be the same as for professional accountants in public practice. Accountants in practice have other professional accountants in the firm with whom they can consult;
- A professional accountant in business would first escalate the matter through the organization;
- A view was expressed that there are some unethical matters that should be disclosed if the matter is not properly resolved – the public would expect a professional accountant to disclose such matters. An alternative view was expressed that the Task Force proposals were appropriate by limiting the disclosure requirements to those matters that are within the professional expertise of the accountant;
- If the Task Force develops additional guidance for professional accountants when encountering an unethical act, care should be taken about its placement. If the

additional guidance is placed in the ethical conflict resolution section, the Task Force should ensure that it has the appropriate prominence;

- Are the requirements clear regarding information that might be acquired about a third party? For example, if a professional accountant in public practice was conducting an acquisition review for a client, and during the course of performing that service acquired information about a suspected illegal act at the target organization – how would the professional accountant address this matter?;
- Section 225 seems to have been written from the perspective of an audit assignment – a professional accountant in public practice performing a non-assurance service might not have access to those charged with governance;
- If an entity approached a professional accountant in practice to assist with back payment of taxes, would the accountant be required to disclose the matter even though the client is trying to resolve the situation?
- What is meant by a "reasonable period of time" in 225.7 and how would the professional accountant assess whether the client intended to disclose the matter? Does the accountant need to have evidence that the client will disclose the matter?
- It is appropriate to require disclosure of illegal acts if appropriate action has not been taken. Without such disclosure, the accountant would be allowing the illegal act to continue, which would not be in the public interest. There does, however, need to be an appropriate level of balance because the accountant is dealing with a suspected illegal act.

Mr. Franchini thanked the IESBA for the input and noted that all the points would be carefully considered by the Task Force.

5. SME/SMP Task Force Report

Mr. Thomson introduced the topic and also introduced Giancarlo Attolini, a member of the Working Group and Deputy Chair of the IFAC's SMP Committee. Mr. Thomson explained that his objective was to advise the IESBA on the challenges and issues faced by professional accountants in SMEs and SMPs and seek input from the IESBA on the Working Group's preliminary report and recommendations. In his introductory comments, Mr. Thomson noted that none of the recommendations are intended to apply to the independence requirements applicable to the audit of a public interest entity as this is outside the scope of the Working Group.

Mr. Thomson explained that SMEs represent more than 98% of businesses worldwide, having a major impact on the economy. They have similar characteristics, which include a limited number of audit/review report users, primarily owner-managed, limited resources, and they value the advice and services of SMPs.

Mr. Thomson noted that the Working Group members have experience with SMEs and SMPs and in order to gain additional insights into the challenges faced the Working Group reviewed relevant reports, compared portions of the IESBA Code to the requirements in various local jurisdictions, discussed issues with the IFAC SMP Committee, and participated in the SMP Forum held in Istanbul, among other outreach and information gathering initiatives.

Mr. Thomson then provided the IESBA with the preliminary recommendations of the Working Group.

Knowledge & Understanding
Lack of resources, including time, funds and qualified individuals available to provide direction and advice, can inhibit the SME and SMP's ability to understand the IESBA Code. The length of the Code also introduces challenges, such as translation from English and the ability to effectively research issues.

Recommendation: - Develop guidance for users, such as Q&As and case studies. Consider publishing a synopsis of the Code and issuing the Code in a format that facilities ready access and ease of use, such as an electronic version of each section.

The IESBA members were supportive of the synopsis as not only a tool for SMPs and SMEs but also for other users, such as regulators. It was noted that care must be taken to ensure that the synopsis does not change the meaning of the Code and that the user understands that the synopsis does not take the place of the Code itself.

Safeguards
Safeguards noted in the IESBA Code appear to be appropriate for most situations, although they vary from section to section. The IESBA Code does provide an "informed management" as a safeguard when discussing management responsibilities. Informed management is viewed as an effective safeguard yet it is not referred to in other sections of the Code or understood by many users of the Code. While there is general support for the threats and safeguards approach to the Code, various member bodies and regulators treat the safeguards noted in the Code as rules, discouraging the use of professional judgment by SMPs.

Recommendation - Consider clarifying the importance of professional judgment and an informed management as an appropriate safeguard.

The IESBA members agreed that the concept of an informed management is important, but an informed management would need to be able and willing to make management decisions, that is, an informed management alone would not be a substitute for management decision making. Providing users with additional guidance or a definition of informed management also would be beneficial.

Safeguards – Sole Practitioners and Smaller SMPs
The Code provides for many safeguards, however many are not readily available to the sole practitioners and small SMPs.

Recommendation - Develop guidance identifying appropriate safeguards for the sole practitioner and the smaller SMP. Informed management along with an appropriate inspection program should be considered.

The IESBA discussed the recommendation noting that the Code should be balanced and appropriate for all users. It was also discussed that it is very important for the use of informed management as a safeguard not to be viewed as allowing a practitioner to perform all types of services for an SME as long as the management is informed.

Network Firm
SMPs develop relationships with correspondents sharing office space, administrative staff, and other resources. These alliances can be confused with the Code's concept of a network firm.

Recommendation - Develop guidance for users such as Staff Questions and Answers on the topic of network firms.

The IESBA accepted the recommendation.

Ongoing Consideration of SMEs and SMPs
The SME and SMP representatives that the working group interacted with noted that the SME and SMP community needs continuing attention by standard setters, including the IESBA.

Recommendation - The IESBA should enhance its current processes to promote greater participation by SMEs and SMPS in its standard setting activities, including having representation on task forces and considering the issues facing SMEs and SMPs when addressing IESBA initiatives. The efforts currently in place should be continued and recognized as important steps toward acknowledgement of the SME and SMP environment. These efforts include the continued search for qualified nominations to the IESBA and CAG if appropriate, close cooperation with the SMP committee and supporting the efforts of the working group.

Further Expansion of the Code
Much of the Code is focused on independence and does not provide guidance on compliance with various fundamental principles when providing specific services other than audits. Many SMPs provide non-assurance services to their SME clients.

Recommendation - When developing future workplans, the IESBA should consider expanding the Code to deal more with non-assurance services to non-assurance clients.

The IESBA accepted the recommendation.

Mr. Thomson concluded the discussion by outlining the next steps, which include addressing the IESBA's feedback and completing interviews with selected candidates in an attempt to provide further validation of the Working Group's recommendations. Mr. Thomson thanked the IESBA members for their input and will present the Working Group's final report and recommendations at the next IESBA meeting.

6. ISA 610 Use of Internal Audit

Mr. Franchini introduced Diana Hillier, Chair of the IAASB Task Force addressing ISA 610, *Using the Work of Internal Auditors*, and Jessie Wong, IAASB staff support for the project, attending by conference call.

The IAASB's project involves revising ISA 610. The objective is to "revise [the clarified] ISA 610 to reflect developments in the internal audit environment and changes in practice regarding the interactions between external and internal auditors."

The issues the Task Force is considering include:

- The external auditor's assessment of the competence and objectivity of the internal audit function; and
- 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 Bob Franchini is a correspondent member on Task Force.

At previous meetings, the IESBA considered the issue of internal auditors providing direct assistance to the external auditor and whether this was appropriate in consideration that they were not independent of the audit client. The IESBA had concluded that the threats and safeguards approach being proposed by the Task Force, by which the external auditor would perform additional review and supervision on the work of the internal auditors, gave adequate recognition to the fact that internal auditors were not independent of the audit client. In view of this, the IESBA also concluded that the definition of engagement team did not need clarification.

The IAASB issued an exposure draft in July 2010. A number of respondents to the exposure draft commented on the apparent inconsistency between the use of internal auditors to perform the external audit procedures and the requirement under the Code for external auditors to be independent of the audit client. Some of these respondents noted how internal auditors performing external audit procedures, in effect, would be part of the engagement team and the Code required that the engagement team be independent of the audit client.

The IESBA discussed the nature of the comments received by the IAASB and agreed that an IESBA Task Force should be established to consider the comments in detail and report back to the IESBA with a recommendation. Mr. Franchini agreed to chair the Task Force and the IESBA invited Ms. Hillier to be a correspondent member of the Task Force.

7. Definition of a Professional Accountant

The IESBA did not discuss this subject. It will be discussed as part of the agenda for the October 2011 meeting.

8. Benchmarking

Mr. Pinkney introduced the topic. He noted that the IESBA Strategy and Work Plan 2011-2012, identifies convergence as a long-term objective of IESBA. It notes that convergence to a single set of independence standards will enhance the efficiency of the global capital markets. The Plan identifies three inter-related convergence efforts. One of these efforts is to analyze the Code for purposes of comparing its key provisions to the standards and regulations of select jurisdictions. The IESBA did this for some provisions of the Code when revising the Code's independence provisions. The Strategy and Work Plan notes that the IESBA believes that when focusing on the Code as the catalyst for convergence between international and national independence standards, it is important to understand how all of the key independence provisions in the Code compare to the independence standards and regulations of other jurisdictions and how in totality the Code compares to those other standards and regulations.

A benchmarking exercise has been undertaken by some Board members and technical advisors. The independence requirements set out in Section 290 of the IESBA Code have been compared to the requirements of the following:

- USA (SEC/PCAOB)
- Australia
- Germany
- UK (APB)
- Brazil
- France
- Japan
- Hong Kong

The comparison was based on the "long document" presented to the Board (which contains a synopsis of the Code's provisions and not, in most cases, the full text of the Code) and focuses only on those relationships and circumstances that are either "prohibited" or "permitted only if certain conditions exist or specified safeguards are applied." Mr. Pinkney stressed that the comparison had been prepared by Board members and technical advisors on a best efforts basis and the results had not been validated by any relevant regulators or member bodies.

Mr. Pinkney led the IESBA through an overview of the differences that had been identified on the following key topics.

- Assignment of responsibility for action
- Communications with those charged with governance
- Partners and staff joining an audit client
- Rotation of audit partners
- Partner rotation – exceptions
- Preparing accounting records and financial statements
- Valuation services
- Tax return preparation
- Tax calculations

- Tax planning advice
- Acting in the resolution of a tax dispute
- Internal audit services
- Designing or implementing IT systems
- Litigation support services
- Other services
- Reliance on fees
- Evaluation and compensation of key audit partners

Mr. Dakdduk noted that at the April IESBA-NSS meeting a key message had been the importance of respecting sovereignty and, in this regard, the objective of a single global independence standard might never be achievable and perhaps the only achievable objective would be use of the independence requirements contained in the Code by foreign auditors of foreign subsidiaries.

The IESBA agreed that the Planning Committee should develop a proposal for the consideration of the IESBA.

9. ISRS Compilation Engagements

Ms. Sapet introduced the topic and Mr. Cowperthwaite, chair of the IAASB Task Force on ISRS 4410 *Compilation Engagements*. The IAASB has a project to revise ISRS 4410 to provide standards for assurance and related services regarding financial statements, other than audits. The IAASB extended an invitation to the IESBA to appoint a correspondent member to the Task Force and Isabelle Sapet agreed to fill this role.

The IAASB issued an exposure draft in October 2010 that would require the practitioner to comply with relevant ethical standards as they relate to compilation engagements. The application guidance stated that while the Code does not require independence in a compilation engagement, national ethical codes, laws, or regulations may specify requirements or disclosure rules pertaining to independence.

Some respondents to the exposure draft believed it is important, if not critical, in a compilation engagement for the practitioner to disclose in the compilation report if the practitioner is not independent of the entity for which the practitioner is compiling information. These respondents disagreed with the proposal to not continue with the requirements and guidance contained in the extant ISRS on this issue, citing the public interest issue of disclosing material information to users. Information that the practitioner's independence is impaired, or perceived to be impaired, is viewed as important information for users.

Some respondents were of the view that the IESBA needs to define independence for compilations and/or related services engagements ("non-assurance engagements").

Ms. Sapet reported that the IAASB Task Force had considered the comments and identified the following alternative approaches to responding to the exposure draft respondents:

(a) Retain the approach in ED-4410. Application material[1] points to the possibility that requirements and/or guidance may exist at the national level. For example, national disclosure requirements may specify the nature and form of required disclosures concerning a practitioner's independence, or lack thereof. Further, nothing would prevent any firm or practitioner from disclosing that information when undertaking compilation engagements under the proposed ISRS.

(b) Retain the approach in the extant ISRS 4410. ISRS 4410.05 states:

> Independence is not a requirement for a compilation engagement. However, where the accountant is not independent, a statement to that effect would be made in the accountant's report.

The practitioner's report is required to include, when relevant, a statement that the auditor is not independent of the entity.

(c) Apply the approach in extant ISRS 4400. ISRS 4400.09 states:

> Independence is not a requirement for agreed-upon procedures engagements; however, the terms or objectives of an engagement or national standards may require the auditor to comply with the independence requirements of the IESBA Code. Where the auditor is not independent, a statement to that effect would be made in the report of factual findings.

(d) Include disclosure requirements in proposed ISRS 4410 that are in line with the provisions of the IESBA Code on disclosure of conflicts of interest, including as a reporting requirement for the practitioner's report.

Subject to comments received from the IESBA, the IAASB Task Force believes that option (d) above is worthy of further consideration for the proposed ISRS, and sees no drawbacks from the inclusion of requirements and appropriate guidance along those lines in the proposed ISRS. Advantages are that the proposal would align with the requirements of the IESBA Code and can be implemented in the proposed ISRS without need for further interpretation in the IESBA Code.

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

- The conflicts of interest requirements that would be contained in the Code would apply to all engagements, not only engagements where a professional accountant is issuing a report;
- Under certain laws, the approach is to first identify that there is an interest and then consider whether there is a conflict. It is important to disclose the interest because that prompts users to evaluate the impact of the interest;
- The degree of objectivity required for a compilation engagement might be different from another engagement;
- Users of compilation reports would want to know whether the practitioner issuing the report had a financial interest in the client;
- It could be seen as different from a conflict of interest because a financial interest in the client would create a mutuality of interest.

[1] ED-4410, paragraph A20

Ms. Sapet and Mr. Cowperthwaite thanked the IESBA members for their input.

10. Remarks from the PIOB

Mr. Dakdduk invited Mr. Ramos, observing on behalf of the PIOB, to make some remarks.

Mr. Ramos indicated that it had been his first direct observation of an Ethics Board. While he had been overseeing IESBA meetings indirectly for two years, and thinks that he is reasonably aware of the strengths and weaknesses of the current standard setting architecture and of the composition of this board. This observation of the meeting had been a learning experience, and he wished to share the lessons he had learnt.

His main conclusion and the one that he really wished to share with IESBA is the importance of the work this Board does for the Public Interest, especially in the present times when business ethics are being so intensely questioned. IESBA has a very special responsibility to the Public Interest, because it deals with accountant and auditors ethics at a moment in time when these are being questioned by many stakeholders, including regulators. This thought has been present with him throughout your discussions.

The two previous PIOB observers to the last CAG and last IESBA meeting have highlighted the need for understanding the meaning of public interest. He drew the attention of the IESBA to the recently published 6th PIOB report, which attempts a definition of Public interest around the following key points:

1. Accountancy services are in the public interest if they create net benefit for the public.
2. The public refers to people as a whole, and not just limited to those that make use of the accounts, although it is perhaps useful to focus on the segment of the public that is directly or indirectly affected by such a service, i.e., the stakeholders.
3. The accountancy profession can best benefit the public by providing information in which the public has confidence.

Mr. Chairman, with this background, he noted that he wishes to focus on what he had learnt over these last two days.

Regardless of the opinions each IESBA member forward, the debates have been highly participatory and inclusive, and he congratulated IESBA members on their dedication, energy and interest.

His overall assessment was that it had not been a particularly easy meeting. He contrasted this conclusion though my informal conversations with members. He acknowledged that some of the topics were not easy to deal with not just by this Board, but by anyone. This is the difficulty with ethics. He noted his remarks would focus on what he thought was most important from a public interest perspective:

1. Quality of process, that is, have all members been able to put forward their views in a balanced and effective manner and have all views been dealt with adequately?
2. Public interest awareness in the contribution of members.
3. Quality of the outcomes of the meeting.

He concentrated his comments on the discussions on breaches to independence and on conflict of interest projects, since these were the most difficult discussions.

He stressed that the PIOB think that the work initiated on preparing a synopsis of the Code for SMEs and SMPs and the benchmarking exercise carried out within the context of convergence are both important priorities, and the PIOB looks forward to further advances on both counts. The IESBA discussion on "Responding to suspected Illegal Acts" that showed an initial alignment of Board views, and good and deep concern for the public interest, for which he commended the Board.

First, in reference to the discussion on breaches to independence:

1. From the point of view of the quality of process, he congratulated the Board for having a Public Member chair the Task force. He was impressed by the quality of the work produced and brought to the Board. He indicated that he looked forward to this instance becoming more of a general trend.

   The discussion led by the chair of the Task force showed deep concern for the public interest, and a clear awareness of the importance to respond adequately to current widespread concerns on business ethics. The initial draft for discussion offered a constructive approach, recognizing that termination may have to occur in case of a breach, proposing to report to the audit committee of the client all independence breaches, and letting the audit committee decide on how material they are and take a decision. This is clearly more in the public interest than the alternative of allowing the audit firm not to report promptly those breaches that the audit firm may judge immaterial, but that the audit committee may think different. The final draft produced during the meeting addressed all comments that had been offered.

   The one concern he did have, and which was not addressed, is that in reality, not all audit committees may warrant such reliance. In those cases when that is not the case, perhaps other alternatives leading to full transparency can also be considered.

2. Regarding the public interest awareness of the contributions: This was the area where he thought the discussions could have had clear room for improvement. The most contentious issues tended to show a divide between practitioners and non-practitioners. Recognizing that all views are legitimate, that they are inspired by genuinely positive willingness to contribute to the debate, and the difficulty of ethical issues, he thought that, at times, the interest of the profession (in contrast to the public interest) seemed to dominate some opinions, or, put differently, that

some views, mainly from practitioners, were not sufficiently aware of the public interest implications.

He could not say whether the outcome of the discussion would have been different otherwise, but he could say that, in his view, the interest of the profession lies today squarely in defending the public interest, and not in protecting its own self-interest. He indicated he was convinced that all members of the Board keep in mind the very significant public interest implications of their work, especially in present times, and are aware of the need to ensure that current regulatory concerns are addressed.

3. Regarding the quality of the outcome of the discussion, he indicated he thought however that it was very positive. In the face of divergent opinions, this conclusion shows the strength of the processes built in the Board discussion: The views of the CAG have been very effectively put forward by the CAG chair, as have those of the public members, practitioners and non-practitioners. The chair was very effective in drawing out all views around the table. The Board seems to have taken them all into account, and it must be commended especially for taking into account so inclusively the CAG comments and those of the public members. He also thought that very good respect for due process was shown when the Chair suggested, and the Board accepted, to produce a new draft on which the CAG could formulate its views. The PIOB will look forward to continuing to monitor the progress of future texts.

Mr. Ramos indicated that his conclusions on conflicts of interest were very similar to the discussion on independence breaches: given divergent opinions, the strength of process in the discussion has, in my opinion, managed to ensure the quality of the outcome.

Again he found that some of the opinions hinged at times more on the interests of the profession that in the public interest, the vigour in the discussion, the respect for process, the effective deliverance of the CAG views by the CAG chair and those of public members as well of practitioners and non-practitioners, all suggest a very positive outcome. This was again effectively facilitated by the efforts of the chair to draw all views around the table: The PIOB will look forward to following the outcome of the reconsideration by the Task Force of the definition of a conflict of interest, of strengthening the “reason to believe” threshold concerning potential conflicts of interest, of dual engagements and of undue pressure on compensation.

He noted that at on the first day of the IESBA meeting, he had reported that, following the Monitoring Group recommendation, the PIOB was reconsidering its oversight methodology, and, particularly, to conduct direct observations more selectively. He noted that the PIOB will take into account the importance of the work of the IESBA in deciding which meetings to observe.

Mr. Dakdduk thanked Mr. Ramos for his remarks.

11. Closing Remarks and Future Meeting Dates

Mr. Dakdduk thanked all participants for their attendance and the Accountants Association of Poland for its kind hospitality in hosting the meeting.

Mr. Dakdduk closed the meeting.

Future meetings of IESBA

- October 17-19, 2011 – New York, USA
- February 20-22, 2012 – New York, USA
- June 18-20, 2012 – Lisbon, Portugal
- October 15-17, 2012 - New York, USA