

Communicating Breaches of Independence Requirements

Purpose of the Discussion

The key questions to be addressed during the session relate to:

- Whether the proposed statement of compliance with relevant ethical requirements remains appropriate when breaches of independence requirements were identified and satisfactorily addressed). Based on discussions to date, it is likely that changes are needed to the requirement proposed in the draft of proposed ISA 700 (Revised)¹ included in **Agenda Item 2-F**.
- Whether breaches of independence requirements should be communicated in the auditor's report in all circumstances that would not otherwise require the auditor to terminate the audit engagement (i.e., the auditor has concluded that action can be taken to satisfactorily address the consequences of the breach). The proposal is, rather than establishing a global requirement to communicate breaches of independence requirements in the auditor's report when they have been identified, to leave the determination about whether to do so to law or regulation in light of the underlying relevant ethical requirements.
- Whether changes should be made to ISA 260² to take into account recent revisions to the International Ethics Standards Board for Accountants' (IESBA) *Code of Ethics for Professional Accountants* (IESBA Code) to communicate with TCWG about breaches of independence requirements.
- Whether ISA 260 should be revised to require communication about independence with TCWG for all entities, rather than only listed entities, to align with the proposal to require a statement of compliance with relevant ethical requirements for all entities and in light of increased focus on the issue of auditor independence.

Objective of Agenda Item

1. This Paper describes key issues pertaining to communicating breaches of independence requirements, including communicating with TCWG in accordance with ISA 260. It has been informed by input from the Auditor Reporting ISA 701 Drafting Team (DT-701), as well as the IAASB Steering Committee. The purpose of the April 2013 IAASB session is to determine an appropriate way forward in the public interest in relation to the possible need to communicate breaches of independence requirements.

¹ ISA 700, *Forming an Opinion and Reporting on Financial Statements*

² ISA 260, *Communication with Those Charged with Governance*

Background

2. The issue has relevance in the context of the Auditor Reporting Project for two reasons:
 - (i) In light of the proposed requirement to include a statement in the auditor's report that, in performing the audit, the auditor has complied with relevant ethical requirements applicable to financial statement audits, including independence; and
 - (ii) In light of the increased focus on matters communicated with TCWG and possible improvements to ISA 260 that may be proposed in connection with the June 2013 Auditor Reporting exposure draft (ED).
3. The June 2012 Invitation to Comment (ITC) noted that some jurisdictions require the auditor to publicly disclose breaches of relevant ethical requirements, and highlighted the IESBA agenda project addressing breaches of the IESBA Code. At that time, the IAASB believed it would be premature to put forth proposals relating to the disclosure of breaches of relevant ethical requirements until such time as the outcome of the IESBA's work was known and the value and impediments of doing so have been fully considered. The IESBA has finalized and released the changes to the IESBA Code addressing breaches of independence requirements, which will be effective in 2014 (see Appendix 2). Accordingly, it is now necessary for the IAASB to consider an appropriate way forward in order to signal a view in the June 2013 ED and, as appropriate, seek feedback from respondents. This paper was discussed by the IESBA Planning Committee and relevant feedback has been incorporated based on that discussion.
4. During recent discussions of the IAASB and IESBA with representatives of the International Organization of Securities Commissions (IOSCO), one IOSCO representative continued to emphasize the view in IOSCO's response to the ITC that public disclosure of breaches of independence requirements in the auditor's report is necessary.

Extant Requirements about Communicating with Those Charged with Governance about Independence

5. Appendix 1 includes the extant requirements about communicating with TCWG about independence in ISA 260 and the IESBA Code. The requirement in paragraph 17 of ISA 260, which applies only to audits of financial statements of listed entities, was developed with reference to the proposed IESBA Code at the time, but was intended to be broader than what was explicitly contemplated in the proposed Code. For example, ISA 260 specifically includes disclosures for listed entities regarding fees to the auditor's firm and network firm, because such disclosures were viewed to be important in assisting those charged with governance in monitoring and protecting the auditor's independence.
6. The IAASB had not previously considered it necessary to establish requirements for auditors of entities other than listed entities to communicate with TCWG about independence matters. This is not to say that such communications would not be relevant to TCWG of an entity other than a listed entity – in fact, paragraph A23 of ISA 260 acknowledges that the communication requirement in ISA 260 may also be relevant in the case of some other entities, particularly those that may be of significant public interest. However, the same paragraph notes the communications may not be relevant in certain circumstances. In particular, the required communication about total fees charged during the period covered by the financial statements for audit and non-audit services

provided by the firm and network firms to the entity and components controlled by the entity may be less relevant.

Interactions with Auditor Reporting

Statement of Compliance with Relevant Ethical Requirements

7. The ITC noted that ISA 700 requires that the description of the auditor's responsibilities in the auditor's report indicate that the auditor is required to comply with ethical requirements. However, when national law or regulation requires the auditor to use specific wording for the auditor's report, no explicit mention of ethical requirements is required. The ITC explained that, because of the importance of compliance with ethical requirements as a basis for the audit, and the increased focus on auditor independence, the IAASB believes that an explicit statement of compliance with relevant ethical requirements should be required in all auditors' reports.
8. In developing the ITC, the IAASB considered, but decided against, suggesting the specific identification of the auditor's ethical code(s) in the auditor's report. While this might provide users with details useful in determining the particular restrictions that apply to the auditor under each code, the IAASB recognized that such a disclosure may be lengthy and complex, as often there are relevant ethical requirements contained in more than one document (such as a professional code of ethics issued by the IESBA or national standard setter (NSS), legislation, and a regulator's or stock exchange's requirements). Therefore, the benefits of naming the ethical code(s) may be outweighed by the impediments of doing so.
9. The ITC did not include a specific question for respondents as to whether this suggested improvement to auditor reporting was appropriate. With the exception of IOSCO as noted above and one other respondent,³ respondents to the ITC did not express views about the inclusion of a statement of compliance with relevant ethical requirements or about communicating breaches of independence requirements in the auditor's report. Accordingly, the ISA 700 Drafting Team (DT-700) agreed to move forward with the inclusion of a statement of compliance with relevant ethical requirements in the auditor's report. DT-700 is proposing the following requirement and application material in proposed ISA 700 (Revised) in **Agenda Item 2-F**:
 28. The auditor's report shall include a section with the heading "Basis for Opinion" that:
 - (a) States that the audit was conducted in accordance with International Standards on Auditing;
 - (b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the ISAs;
 - (c) Indicates compliance with relevant ethical requirements applicable to financial statement audits, including independence requirements; and
 - (d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

³ Ordem dos Revisores Oficiais de Contas (OROC), an IFAC Member Body that supported identification of the ethical code

A28. In accordance with ISA 200, the auditor does not represent compliance with ISAs in the auditor's report unless the auditor has complied with the requirements of:

- All ISAs relevant to the audit; and
- All relevant ethical requirements, including those pertaining to independence relating to financial statement audits.⁴

When indicating compliance with relevant ethical requirements, the auditor may identify the source(s) of those relevant ethical requirements, or include statements about the auditor's independence, or information about non-compliance with relevant ethical requirements.

The proposed application material above is intended to acknowledge the need for flexibility in auditor reporting regarding independence. This additional information may be required by law or regulation, or the auditor may judge it appropriate to provide this information based on the facts and circumstances of the engagement.

10. However, some concern has been expressed that it could be seen as misleading for the auditor to include a statement of compliance with relevant ethical requirements, *including independence requirements*, when breaches of independence requirements have occurred. Notwithstanding the proposed application material in paragraph 9, the IAASB will need to conclude about whether breaches of independence requirements should be required to be disclosed externally when they have been identified.
11. Previous discussions of the Auditor Reporting Clarifications Subcommittee have acknowledged that public disclosure of breaches of independence requirements may enable users to make their own assessment of the degree to which they perceive the auditor's independence to be affected by a breach. However, such a disclosure may undermine confidence in audits by leading users to the erroneous belief that the auditor is not independent. Auditors are required to conclude on their compliance with relevant ethical requirements and take the appropriate action, including terminating the engagement if necessary, meaning that auditors must have resolved that they are independent in order for the auditor's report to be issued.
12. Through the recent amendments, the IESBA Code puts into place the need for the *firm* to obtain the concurrence of TCWG that action can be, or has been, taken to satisfactorily address the consequences of the breach. Importantly, the requirements of the IESBA Code apply to *all* breaches of independence in relation to the entity across the entire firm, regardless of significance. In deliberating what should be required to be communicated about breaches, the IESBA was of the view that it would be inappropriate to require public reporting in a code of ethics for global application and that if a regulator in a particular jurisdiction believes that reporting to the regulator and/or investors is appropriate in that jurisdiction, the regulator should require such reporting. The IESBA also acknowledged that establishing requirements regarding the content of the auditor's report was outside of its remit.
13. In addition, the IOSCO response to the ITC noted the following: "While we are supportive of the inclusion of a statement concerning compliance with relevant ethical requirements, we believe that with respect to independence it may be more appropriate for the opinion to specifically state that

⁴ ISA 200, paragraphs 14 and 20

the auditor is independent of the audited entity. More specifically, we believe where a breach of an auditor independence provision of the Code has occurred, if objectivity was deemed not to be compromised, the auditor should report the occurrence and nature of the breach and the impact on the auditor's objectivity in jurisdictions where such reporting is either required or encouraged under the capital markets regulatory regime. Such a statement would be consistent with the title of the auditor's report ("Independent Auditor's Report"). Implicitly, we believe if the auditor is not independent and objectivity has been compromised then the auditor will not be able to issue the auditor's report."

14. DT-701 is of the view that IOSCO's recommendation to report breaches *in jurisdictions where such reporting is either required or encouraged under the capital markets regulatory regime* may suggest that it may be more appropriate for law or regulation, rather than the IAASB, to require disclosure of breaches of independence requirements in the auditor's report or by some other public means. This is consistent with the Building Blocks approach and acknowledged by the proposed application material in paragraph 9, and is also consistent with the IESBA's view as to what may be appropriate. DT-701 therefore recommends that the IAASB does not propose a global requirement for auditors to report breaches of independence requirements in the auditor's report.
15. However, DT-701 also recognized that including a statement in the auditor's report that the auditor has "complied with relevant ethical requirements applicable to financial statements, including independence requirements" may be viewed as being inconsistent when the auditor has identified breaches of independence requirements. In previous discussions, the Clarifications Subcommittee acknowledged this view, but noted that, in the case of the IESBA Code, if the auditor has concluded that action can be taken to satisfactorily address the consequences of the breach, and TCWG concur with this, the auditor can assert independence and issue the report with the title "Independent Auditor's Report".
16. Discussions with the IESBA Planning Committee have indicated that the difficulty relates to the use of the phrase "have complied with" in relation to relevant ethical requirements. Similar concerns were noted by a few Representatives at the April 2013 IAASB Consultative Advisory Group (CAG) meeting. Importantly, the auditor is not required to include an explicit statement of compliance with ISAs or the applicable financial framework in the auditor's report, and so it may be seen as inconsistent that such a statement would be needed in relation to the ethical requirements, which may be more conceptual than requirements in auditing or financial reporting standards. It was therefore suggested that it might be more appropriate for the explicit statement in the auditor's report to be amended as follows: "We have complied with the requirements and responsibilities under [source(s) of relevant ethical requirements] relating to independence and other relevant ethical requirements applicable to our audit of the financial statements." Doing so would provide transparency about the ethical requirements that applied to the audit but would avoid the auditor including a statement that may be perceived as misleading when breaches of independence requirements were identified but appropriately resolved. It also would mitigate the possibility that the auditor's report could be considered inappropriate if the auditor was unaware that breaches of independence had occurred (for example, by employees of the firm who are not part of the engagement team). In addition, it was reiterated that the required title "Independent Auditor's Report" is viewed as a confirmation of the auditor's independence.

17. It was noted that further thought may need to be given as to how to explain in application material in proposed ISA 700 that it may not be appropriate to list all sources of relevant ethical requirements, in particular in the context of group audit engagements, but rather the primary ethical requirements that directly applied to the engagement partner and members of the group engagement team (for example, the IESBA Code and the securities regulation of the home country). On balance, further IAASB deliberations on the topic of breaches of independence without input from stakeholders may be unproductive. The IAASB will first need to conclude on whether it would be appropriate to put forth a proposed requirement for the auditor to include a reference to relevant ethical requirements, and how best to do so in light of the interaction with the recent revisions to the IESBA Code relating to breaches of independence requirements as explained above. The Explanatory Memorandum in the Auditor Reporting ED could seek feedback on the appropriateness of, and value derived from, the statement of compliance with relevant ethical requirements. If supported, the rationale for not requiring public disclosure of breaches can be explained and respondents can be asked for views as to whether this is appropriate and what the implications of breaches may be on the proposed statement of compliance.

Matters for IAASB Consideration

1. What are the IAASB's views as to whether auditors should be required to disclose breaches of independence requirements in all cases in the auditor's report?
2. What are the IAASB's views as to how the proposed statement addressing relevant ethical requirements could be articulated in the auditor's report?

Communicating Breaches to TCWG

18. The recently finalized changes to the IESBA Code prescribe particular communications to TCWG when breaches of independence requirements have been identified. In light of DT-701's recommendation that the June 2013 auditor reporting ED should include proposed changes to ISA 260 (see **Agenda Item 2-B**), it is useful for the IAASB to explore at this time whether the required communications between the auditor and TCWG in relation to breaches of independence requirements need to be strengthened.
19. The ISAs note that relevant ethical requirements ordinarily comprise Parts A and B of the IESBA Code related to an audit of financial statements, together with national requirements that are more restrictive. In many cases, jurisdictions adopting the ISAs apply a national ethical code that they have asserted complies with the IESBA Code. However, national ethical codes may not utilize a threats and safeguards approach similar to the IESBA Code, or may establish different requirements when breaches of independence requirements have been identified (e.g., more prescriptive requirements may exist relating to termination of the audit engagement, or the concept of a breach may be defined in more detail). Accordingly, within the ISAs there is a need to ensure adequate flexibility for jurisdictions that may require reporting on breaches to TCWG (or externally in different ways).
20. The requirement in paragraph 17 of ISA 260 can be read as addressing breaches of independence requirements, as breaches would be considered a relationship or matter that may reasonably be thought to bear on independence. The application material in paragraph A22 notes that the communication required by paragraph 17(a) of ISA 260 may include an inadvertent violation of

relevant ethical requirements as they relate to auditor independence, and any remedial action taken or proposed. However, the application material in ISA 260 could be enhanced to acknowledge the explicit communication required by the IESBA Code as follows (shown in marked from extant ISA 260):

- A22. The relationships and other matters, and safeguards to be communicated, vary with the circumstances of the engagement, but generally address:
- (a) Threats to independence, which may be categorized as: self-interest threats, self-review threats, advocacy threats, familiarity threats, and intimidation threats; and
 - (b) Safeguards created by the profession, legislation or regulation, safeguards within the entity, and safeguards within the firm's own systems and procedures.

~~The communication required by paragraph 17(a) may include an inadvertent violation of relevant ethical requirements as they relate to auditor independence, and any remedial action taken or proposed.~~

- A22A. Relevant ethical requirements or law or regulation may also specify particular communications to those charged with governance in circumstances where breaches of independence requirements have been identified. For example, the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code) requires the auditor to communicate with those charged with governance in writing about the breach and the action the firm has taken or proposes to take.⁵

- A23. The communication requirements relating to auditor independence that apply in the case of listed entities may also be relevant in the case of some other entities, particularly those that may be of significant public interest because, as a result of their business, their size or their corporate status, they have a wide range of stakeholders. Examples of entities that are not listed entities, but where communication of auditor independence may be appropriate, include public sector entities, credit institutions, insurance companies, and retirement benefit funds. On the other hand, there may be situations where communications regarding independence may not be relevant, for example, where all of those charged with governance have been informed of relevant facts through their management activities. This is particularly likely where the entity is owner-managed, and the auditor's firm and network firms have little involvement with the entity beyond a financial statement audit.

21. The proposed new application material has the benefit of reminding auditors of their obligations under the IESBA Code while also explaining that national ethical requirements or law or regulation may specify particular communications as well. This approach does not explicitly duplicate in detail all the specific communication requirements in the IESBA Code, allowing for flexibility when ethical codes other than the IESBA code are applied and minimizing the amount of material that would need to be incorporated into proposed ISA 260 (Revised).
22. Alternatively, the IAASB could consider an approach whereby the new requirements in the IESBA Code to communicate about breaches of independence requirements are incorporated as new requirements in proposed ISA 260 (Revised) to fully align the two. Doing so would set a baseline for

⁵ See Section 290.39–50 of the IESBA Code, which addresses breaches of independence.

communications in all circumstances, whether or not the IESBA Code had been adopted. However, this would not be consistent with the approach taken to date to address interactions between the ISAs and the IESBA Code, in light of the circumstances noted in paragraph 19 (i.e., law, regulation or a national ethical code may already have requirements to communicate about breaches that do not parallel or align with the IESBA Code, or may take a different approach to communicating breaches).

23. On balance, rather than incorporating a requirement for a single topic at this time (e.g., breaches of independence requirements), it may be more appropriate in due course for a more fulsome review to be undertaken to identify other areas where greater alignment would be beneficial.

Communication about Independence to TCWG for Entities Other than Listed Entities

24. Notwithstanding the proposal above relating to communication with TCWG about breaches of independence requirements for listed entities, it is necessary for the IAASB to also consider the broader issue of applicability of the requirement in paragraph 17 of ISA 260 to entities other than listed entities, given that Section 290 of the IESBA Code (including those requirements relating to breaches) applies for audits of *all* entities, not just listed entities.
25. There may be some merit in requiring communications about independence for all entities, due to the importance of independence and concerns over ISA 260 only partially acknowledging the communication requirements established by the IESBA Code. However, this would not be an inconsequential change in practice and would likely require fuller debate by the IAASB than can be achieved in the near term. As noted in paragraph 6, at the time ISA 260 was finalized the IAASB did not believe it was necessary to establish a communication requirement relating to independence for entities other than listed entities and was sensitive to overburdening auditors of those entities where such standardized communication may be less meaningful. There is nothing to indicate that these considerations are not still valid.
26. In addition, as noted above, since the requirement to communicate about breaches is already established by the IESBA Code, reporting on independence to TCWG is essentially required when an issue is noted (i.e., on an exception basis), which may be more appropriate rather than establishing an overarching requirement for all entities (which would presumably need to be in writing to be consistent with extant ISA 260).
27. Finally, at the time the auditor reporting project proposal was approved, the potential changes to ISA 260 that were contemplated were those necessary to underpin auditor reporting, rather than a substantive revision of ISA 260. Some, in particular auditors of small- and medium-sized entities (SMEs), may perceive new requirements to communicate about independence to TCWG as a more substantive change than may be appropriate at this time.

Matters for IAASB Consideration

3. In light of the IAASB's overall views about the appropriateness of proposing changes to ISA 260 at this time, what are IAASB's views about the proposed new application material in ISA 260 to provide a link to the new communication requirements in the IESBA Code?
4. What are the IAASB's views about whether auditors of entities other than listed entities should be required to communicate about independence with TCWG?

5. What are the IAASB's views about whether and, if so, how the June 2013 ED should address the topic of independence?

Breaches as KAMs

28. As explained in paragraph 14, law or regulation may require public disclosure about breaches of independence requirements and it is proposed that communication about breaches should not be mandated within the auditor's report in all circumstances. However, because independence matters are required to be communicated to TCWG for listed entities, the criteria in proposed ISA 701 could be viewed as allowing for the possibility of breaches of independence requirements being determined to be a KAM if there was a significant amount of time devoted to discussing and resolving the matter by the auditor and TCWG. In circumstances where a breach has occurred, it is likely that the auditor will have undertaken consultation within the firm and may have sought legal advice, which relates to the proposed criteria relating to "the difficulty of the judgment involved." However, if a discussion of breaches is of such significance that it would be deemed by the auditor as a key audit matter or have been the subject of significant discussion with TCWG, there may be a question of whether the auditor could conclude that independence was not an issue.
29. Previous IAASB discussions noted concerns that, without the ability to engage in a robust two-way communication similar to that undertaken with TCWG, users may not be able to appropriately consider these disclosures in the context in which they are intended. For this reason, DT-701 agreed that proposed ISA 701 should stay silent on the issue, leaving the discussions on independence between the auditor and TCWG. DT-701 also considered whether to prohibit disclosures of breaches of independence requirements, unless required by law or regulation, but did not believe it would be appropriate to restrict the auditor's judgment unnecessarily.

Matter for IAASB Consideration

6. Does the IAASB agree with DT-701's view that proposed ISA 701 should not address the possibility of breaches of independence requirements as KAM?

Extant Requirements about Communicating with Those Charged with Governance about Independence

ISA 260

1. Paragraph 17 of ISA 260 includes a specific requirement for auditors of listed entities to communicate with TCWG regarding auditor independence:

In the case of listed entities, the auditor shall communicate with those charged with governance:

- (a) A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence; and
 - (i) All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor; and
 - (ii) The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level. (Ref: Para. A21–A23)

2. Related application material to this paragraph is included in ISA 260 as follows:

A21. The auditor is required to comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements.⁶

A22. The relationships and other matters, and safeguards to be communicated, vary with the circumstances of the engagement, but generally address:

- (a) Threats to independence, which may be categorized as: self-interest threats, self-review threats, advocacy threats, familiarity threats, and intimidation threats; and
- (b) Safeguards created by the profession, legislation or regulation, safeguards within the entity, and safeguards within the firm's own systems and procedures.

The communication required by paragraph 17(a) may include an inadvertent violation of relevant ethical requirements as they relate to auditor independence, and any remedial action taken or proposed.

A23. The communication requirements relating to auditor independence that apply in the case of listed entities may also be relevant in the case of some other entities, particularly those that may be of significant public interest because, as a result of their business, their size or their corporate status, they have a wide range of

⁶ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 14

stakeholders. Examples of entities that are not listed entities, but where communication of auditor independence may be appropriate, include public sector entities, credit institutions, insurance companies, and retirement benefit funds. On the other hand, there may be situations where communications regarding independence may not be relevant, for example, where all of those charged with governance have been informed of relevant facts through their management activities. This is particularly likely where the entity is owner-managed, and the auditor's firm and network firms have little involvement with the entity beyond a financial statement audit.

IESBA Code

3. Section 290 of the IESBA Code addresses independence requirements for all audits and requires communication with TCWG in relation to mergers and acquisitions; accounting and bookkeeping services; tax calculations; internal audit services; reporting of fees when fees from the audit of a public interest entity exceed 15% of the firm's total fees; and provision of non-audit services.
4. Section 290.28 of the IESBA Code notes the following:

Even when not required by the Code, applicable auditing standards, law or regulation, 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. Such communication enables those charged with governance [TCWG] to:

- (a) Consider the firm's judgments in identifying and evaluating threats to independence,
- (b) Consider the appropriateness of safeguards applied to eliminate them or reduce them to an acceptable level, and
- (c) Take appropriate action.

Such an approach can be particularly helpful with respect to intimidation and familiarity threats.

Appendix 2

Changes to the IESBA Code Issued in March 2013

Note: The shaded paragraphs below establish requirements for the firm to communicate with TCWG.

Paragraph 100.10 would be deleted and replaced with the following:

100.10 Sections 290 and 291 contain provisions with which a professional accountant shall comply if the professional accountant identifies a breach of an independence provision of the Code. If a professional accountant identifies a breach of any other provision of this Code, the professional accountant shall evaluate the significance of the breach and its impact on the accountant's ability to comply with the fundamental principles. The accountant shall take whatever actions that may be available, as soon as possible, to satisfactorily address the consequences of the breach. The accountant shall determine whether to report the breach, for example, to those who may have been affected by the breach, a member body, relevant regulator or oversight authority.

Paragraph 290.39, and its heading, would be deleted and replaced with the following heading and paragraphs 290.39-290.50.

Breach of a Provision of this Section

- 290.39 A breach of a provision of this section may occur despite the firm having policies and procedures designed to provide it with reasonable assurance that independence is maintained. A consequence of a breach may be that termination of the audit engagement is necessary.
- 290.40 When the firm concludes that a breach has occurred, the firm shall terminate, suspend or eliminate the interest or relationship that caused the breach and address the consequences of the breach.
- 290.41 When a breach is identified, the firm shall consider whether there are any legal or regulatory requirements that apply with respect to the breach and, if so, shall comply with those requirements. The firm shall consider reporting the breach to a member body, relevant regulator or oversight authority if such reporting is common practice or is expected in the particular jurisdiction.
- 290.42 When a breach is identified, the firm shall, in accordance with its policies and procedures, promptly communicate the breach to the engagement partner, those with responsibility for the policies and procedures relating to independence, other relevant personnel in the firm, and, where appropriate, the network, and those subject to the independence requirements who need to take appropriate action. The firm shall evaluate the significance of that breach and its impact on the firm's objectivity and ability to issue an audit report. The significance of the breach will depend on factors such as:
- The nature and duration of the breach;
 - The number and nature of any previous breaches with respect to the current audit engagement;

- Whether a member of the audit team had knowledge of the interest or relationship that caused the breach;
- Whether the individual who caused the breach is a member of the audit team or another individual for whom there are independence requirements;
- If the breach relates to a member of the audit team, the role of that individual;
- If the breach was caused by the provision of a professional service, the impact of that service, if any, on the accounting records or the amounts recorded in the financial statements on which the firm will express an opinion; and
- The extent of the self-interest, advocacy, intimidation or other threats created by the breach.

290.43 Depending upon the significance of the breach, it may be necessary to terminate the audit engagement or it may be possible to take action that satisfactorily addresses the consequences of the breach. The firm shall determine whether such action can be taken and is appropriate in the circumstances. In making this determination the firm shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing the significance of the breach, the action to be taken and all the specific facts and circumstances available to the professional accountant at that time, would be likely to conclude that the firm's objectivity would be compromised and therefore the firm is unable to issue an audit report.

290.44 Examples of actions that the firm may consider include:

- Removing the relevant individual from the audit team;
- Conducting an additional review of the affected audit work or re-performing that work to the extent necessary, in either case using different personnel;
- Recommending that the audit client engage another firm to review or re-perform the affected audit work to the extent necessary; and
- Where the breach relates to a non-assurance service that affects the accounting records or an amount that is recorded in the financial statements, engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.

290.45 If the firm determines that action cannot be taken to satisfactorily address the consequences of the breach, the firm shall inform those charged with governance as soon as possible and take the steps necessary to terminate the audit engagement in compliance with any applicable legal or regulatory requirements relevant to terminating the audit engagement. Where termination is not permitted by law or regulation, the firm shall comply with any reporting or disclosure requirements.

290.46 If the firm determines that action can be taken to satisfactorily address the consequences of the breach, the firm shall discuss the breach and the action it has taken or proposes to take with those charged with governance. The firm shall discuss the breach and the action as soon as possible, unless those charged with governance have specified an alternative timing

for reporting less significant breaches. The matters to be discussed shall include:

- The significance of the breach, including its nature and duration;
- How the breach occurred and how it was identified;
- The action taken or proposed to be taken and the firm's rationale for why the action will satisfactorily address the consequences of the breach and enable it to issue an audit report;
- The conclusion that, in the firm's professional judgment, objectivity has not been compromised and the rationale for that conclusion; and
- Any steps that the firm has taken or proposes to take to reduce or avoid the risk of further breaches occurring.

290.47 The firm shall communicate in writing with those charged with governance all matters discussed in accordance with paragraph 290.46 and obtain the concurrence of those charged with governance that action can be, or has been, taken to satisfactorily address the consequences of the breach. The communication shall include a description of the firm's policies and procedures relevant to the breach designed to provide it with reasonable assurance that independence is maintained and any steps that the firm has taken, or proposes to take, to reduce or avoid the risk of further breaches occurring. If those charged with governance do not concur that the action satisfactorily addresses the consequences of the breach, the firm shall take the steps necessary to terminate the audit engagement, where permitted by law or regulation, in compliance with any applicable legal or regulatory requirements relevant to terminating the audit engagement. Where termination is not permitted by law or regulation, the firm shall comply with any reporting or disclosure requirements.

290.48 If the breach occurred prior to the issuance of the previous audit report, the firm shall comply with this section in evaluating the significance of the breach and its impact on the firm's objectivity and its ability to issue an audit report in the current period. The firm shall also consider the impact of the breach, if any, on the firm's objectivity in relation to any previously issued audit reports, and the possibility of withdrawing such audit reports, and discuss the matter with those charged with governance.

290.49 The firm shall document the breach, the action taken, key decisions made and all the matters discussed with those charged with governance and any discussions with a member body, relevant regulator or oversight authority. When the firm continues with the audit engagement, the matters to be documented shall also include the conclusion that, in the firm's professional judgment, objectivity has not been compromised and the rationale for why the action taken satisfactorily addressed the consequences of the breach such that the firm could issue an audit report.

The following paragraphs in the Code will be deleted: 290.117; 290.133; and 290.159