Agenda Item A-2

Draft Minutes of the Meeting of the

IESBA Consultative Advisory Group (CAG)

Held on September 12, 2012 in New York, USA

Present: **Representatives of Member Organizations**

Richard Fleck (Chair)	Financial Reporting Council (FRC), UK
Markus Franz Grund	Basel Committee on Banking Supervision
Kristian Koktvedgaard	BusinessEurope
Matthew Waldron	CFA Institute
Marie Lang	European Federation of Accountants and Auditors for SMEs
Jean-Luc Peyret	European Federation of Financial Executives' Institutes
Hilde Blomme	Fédération des Experts Comptables Européens (FEE)
Philip Johnson	FEE
Nagendra Shivaraya	Gulf States Regulatory Authorities
Glenn Darinzo	Institute of Internal Auditors (IIA)
Richard Thorpe	International Association of Insurance Supervisors (IAIS)
Nigel James	International Organization of Securities Commissions (IOSCO)
Koichiro Kuramochi	IOSCO
Gaylen Hansen	National Association of State Boards of Accountancy (NASBA)
David Morris	North American Financial Executives Institute
Dominique Pannier	Organisation for Economic Cooperation and Development (OECD)
Ajith Ratnayake	Sri Lanka Accounting and Auditing Standards Monitoring Board
Simon Bradbury	World Bank
Irina Lopez	World Bank
Linda de Beer	World Federation of Exchanges and IAASB CAG

Obervers

Martin Baumann[1]	U.S. Public Company Accounting Oversight Board (PCAOB)
Brian Bluhm	IFAC Small and Medium Practices (SMP) Committee

[1] Views expressed by PCAOB Representatives represent their views and do not necessarily reflect the view of the PCAOB Board or PCAOB members or other staff.

Public Interest Oversight Board (PIOB)

	Michael Hafeman	PIOB Member

IESBA

	Jörgen Homquist	IESBA Chair
	Jim Gaa (am only)	IESBA Member
	Gary Hannaford (am only)	IESBA Member
	Peter Hughes (am only)	IESBA Member
	Stefano Marchese	IESBA Member

IESBA Staff

	Jan Munro	IESBA Deputy Director
	Ken Siong	IESBA Acting Deputy Director
	Chris Jackson (am only)	IESBA Technical Manager
Regrets:	Conchita Manabat	Asian Financial Executives Institutes
	Dr Juan Maria Arteagoitia	European Commission (EC)
	Georges Couvois	European Federation of Financial Executives' Institutes
	Obaid Saif Hamad Al Zaabi	Gulf States Regulatory Authorities
	Bengt Hallqvist	International Corporate Governance Network (ICGN)
	Andrew Baigent	International Organisation of Supreme Audit Institutions (INTOSAI)

A. Opening Remarks

Mr. Fleck welcomed all participants to the meeting, noting that he would continue to chair the IESBA CAG until June 2013. He welcomed, in particular, new CAG representatives Mr. Shivaraya (representing the Gulf States Regulatory Authority), replacing Mr. Koster; Mr Grund who previously represented IOSCO and now represents the Basel Committee on Banking Supervision; and Mr. Thorpe, representing the IAIS. He also welcomed Mr. Hafeman, observing on behalf of the PIOB. He noted that apologies had been received from Ms. Manabat, Dr. Arteagoitia, and Messrs. Al Zaabi, Baigent, Couvois, and Hallqvist.

The minutes of the March 2012 CAG meeting were approved as presented.

B. Report from IESBA Chair

Mr. Holmquist introduced himself as the first independent chair of the IESBA, sharing his background and an overview of his vision for IESBA. Amongst other matters, he indicated that he saw the IESBA's role as developing high quality practical standards that can be used directly or used to inspire legislation. He emphasized outreach as an important part of his role in order to better understand the concerns of regulators and the profession, amongst others. He added that while the IESBA had over the recent past focused its work primarily on ethical standards for professional accountants in public practice, it would seek to rebalance its work program towards professional accountants in business (PAIBs).

Mr. Holmquist provided an update on IESBA activities since the previous CAG meeting. He noted in particular that the IESBA had approved an exposure draft at its June 2012 meeting on the topic of responding to a suspected illegal act, with two votes against and one member absent. He noted that the IESBA was anticipating a high level of response on this document. Mr. Holmquist also noted that the IESBA had issued in July 2012 an exposure draft of a proposed change to the definition of the term "those charged with governance" as a result of the project addressing a breach of a requirement of the IESBA *Code of Ethics for Professional Accountants* (the Code).

Mr. Holmquist recorded that Mr. Fleck, Mr. Wymeersch (PIOB Chair), and he had thanked Mr. Dakdduk, the retiring IESBA chair, at the 2012 June IESBA meeting. He also noted that Ms. Munro would be leaving the IESBA at the end of September 2012 and wished her well in her future endeavors.

In response to a question from Mr. Baumann, Mr. Fleck noted that the UK FRC was proposing a change to the combined code that would require FTSE 350 companies to tender the audit every ten years on a comply or explain basis. The proposal would be effective on October 1, 2012 if approved.

Mr. Johnson noted that the EC is proposing mandatory firm rotation every six years and that there had been a counter suggestion of 25 years. There were varying views on the issue amongst EU member states.

Ms. Munro reported that the IESBA national standard setter (NSS) liaison group met in April 2012, with good engagement from the participants and constructive input on the IESBA's key projects. The NSS had been supportive of the IESBA's work. The plan for 2013 is to encourage further engagement.

C. Conflicts of Interest

Mr. Hughes introduced the topic, providing an overview of significant comments received on the December 2011 exposure draft (ED) of the proposed changes to the Code addressing conflicts of interest and the IESBA's preliminary responses with respect to those significant comments at its June

2012 meeting. He noted that the IESBA would consider remaining ED comments at its December 2012 meeting.

In relation to the last sentence of paragraph 220.1, which proposed to require the professional accountant not to allow a conflict of interest to compromise professional judgment, Mr. Baumann wondered if the use of professional judgment could result in a conflict not being disclosed. Mr. Hughes responded that the circumstances in which disclosure would be made were already explained in paragraph 220.8.

Mr. Morris wondered how the professional accountant should respond when informed about a conflict that the professional accountant had not previously identified. Mr. Hughes noted that such a matter was already contemplated within the description of a conflict of interest; accordingly, the professional accountant would address it. Mr. Morris expressed the view that because there is no definition of a conflict of interest, there should be guidance on how the professional accountant should act. Mr. Fleck agreed that it would be unacceptable for a professional accountant to ignore such a matter and asked the Task Force to consider the matter.

CONFLICTS OF INTEREST AND INDEPENDENCE

Ms. De Beer referred to direct reporting engagements under ISAE 3000[2] whereby the assurance provider is responsible both for evaluating the subject matter of the engagement and for expressing an opinion. The IAASB had considered whether a conflict could exist in this situation. She asked whether the description of a conflict of interest would cover this situation. Mr. Hughes indicated that this situation is covered by Section 291.[3] Ms. De Beer commented that threats to independence and threats to objectivity are subtly different, and the difference may be missing from the ED. Mr. Hughes noted that the Task Force would wish to consider the relationship among independence, objectivity and conflicts of interest.

Mr. Hansen commented that conflicts are often about relationships between parties and the conflict is broader than a situation where the subject matter of the accountant's professional service relates to the subject to the conflict between the parties. Mr. Hughes responded that in order for a professional conflict to be created, there should be a linkage between the service and the particular matter on which the parties' interests conflict; the greater the linkage, the greater the conflict. Consequently, the Task Force was of the view that in general having two audit clients who have some conflicting or competing interest between them does not create a professional conflict for the auditor if the auditor does not provide professional services in relation to the conflicting or competing interest. Mr. Hansen expressed the view that the auditor possessing knowledge could create a conflict of interest because it could be detrimental to one client if that knowledge were disclosed to the other client.

Mr. Fleck noted that it would be important to distinguish between professional, commercial and legal relationships. He noted that in the UK, a professional accountant could not act for one party if the professional accountant held relevant information derived in confidence from another client and could not safeguard confidentiality of that information if the professional accountant were to accept the engagement. He asked the Task Force to consider how this issue was reflected in the proposal. Mr. Hughes noted that paragraph 220.9 addresses the situation when it is not possible to disclose a conflict

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2 ISAE 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

3 Section 291, *Independence – Other Assurance Engagements*

without breaching confidentiality and that confidentiality matters in general are addressed in Section 140.[4]

"REASON TO BELIEVE" TEST

Mr. Baumann asked how the "reason to believe" test in the proposed Section 220[5] compared with the network tests in the Independence sections 290[6] and 291. He wondered whether more should be done to distinguish between conflicts of interest and independence. Mr. James asked whether there should be different tests for auditors and assurance providers. Ms. De Beer, supported by Messrs. Hansen and Baumann, asked why the "reason to believe test" in conflicts of interest is weaker than that used in Section 290.

Mr. Morris was of the view that there was an interaction between the proposed Section 220 and Section 290 which was complex and difficult to understand. He felt that Section 290 should override the proposed Section 220 and suggested that the solution could be a cross reference. Mr. Hughes responded that Section 220 applies to all professional accountants in public practice. He said that some respondents had suggested a cross reference from Section 220 to Section 290 but that the Task Force had not yet considered the matter.

Mr. Koktvedgaard asked whether cases exist where the professional accountant does not need to be independent. Mr. Hughes noted if the professional accountant is undertaking an audit, the professional accountant would refer to section 290. If the professional accountant is not undertaking an assurance engagement, the professional accountant should turn to section 220.

Mr. Koktvedgaard also asked what systems should be in place to identify conflicts. He felt that the "reason to believe" test was too weak. Mr. Hughes noted that Section 220 does not mandate systems. Mr. Fleck said that some networks are extensive and some connections between firms in those networks are thin, making a rigorous test difficult. It was noted that a systems requirement could have an adverse impact on the provision of services by medium-sized firms with thin connections.

Mr. Fleck asked if there was any common theme amongst the six respondents to the ED who did not agree with the "reason to believe" threshold. Mr. Hughes noted that most of these respondents were of the view that the threshold should be strengthened.

Ms. De Beer gave the example of a firm being asked to prepare a sustainability report when another part of the network has set up the systems. She noted that the "reason to believe" test is a test of the network's processes. Ms. De Beer said that a cross reference is needed.

Mr. James asked whether an analysis had been prepared of responses by category of respondent. Mr. Hughes confirmed that the agenda paper to the IESBA had contained this analysis.

Mr. Fleck felt that amongst CAG Representatives it was not unclear that the "reason to believe" threshold, as drafted, was sufficiently strong to demonstrate that accountants are acting in the public interest. He suggested that the IESBA may wish to consider these matters.

PUBLIC INTEREST

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4 Section 140, *Confidentiality*

5 Proposed revised Section 220, *Conflicts of Interest*

6 Section 290, *Independence – Audit and Review Engagements*

To illustrate IOSCO's view that the proposal did not appear to adequately address the public interest, Mr. Kuramochi used an example whereby the auditor of Company A becomes aware during the audit of a suspected fraud in Company A and wishes to reach out to an external party, Company B, to gather further evidence about the matter. Mr. Kuramochi indicated that in this case, because the auditor is paid by Company A, Company A would be able to pressurize the auditor not to contact Company B to obtain the necessary information and as a result, there would be a risk that the auditor would place Company A's interests ahead of the public interest. Mr. Fleck commented that in this case, it would be more of a limitation of scope that is addressed by auditing standards.

Mr. Hansen supported IOSCO's response that the public interest is a fundamental principle. He noted that there were situations when it would be necessary to decline an engagement and felt that paragraph 220.10 should be given greater prominence, perhaps towards the beginning of the Section. Mr. Ratnayake supported the suggestion that the public interest should be a fundamental principle.

DOCUMENTATION

Mr. Koktvedgaard asked how the documentation requirements apply. Mr. James commented that the accountant should document the safeguards in paragraph 220.7 that are to be applied. Mr. Thorpe commented that what a reasonable and informed third party would conclude under that third party test is unclear; therefore, clear disclosure of conflicts to the client and sufficient documentation would be necessary.

Mr. Koktvedgaard endorsed the views of Messrs. James and Thorpe. Mr. Baumann felt that the CAG Representatives had given a strong sentiment on this matter. Mr. Hughes responded that the Task Force would consider the documentation requirements. He noted, however, that documentation does not in itself determine if the professional accountant's conduct is compliant with the fundamental ethical principles.

THIRD PARTY TEST

Mr. Bluhm noted that the third party test applies in identifying and evaluating a conflict of interest and implementing safeguards. He suggested that the third party test be repeated in paragraphs 220.5 and 220.6 in case the paragraphs are read in isolation. He also suggested that paragraphs 220.7 and 220.10 should be linked as both relate to safeguards.

FEEDBACK TO CAG

Mr. Fleck commented that if the IESBA were to be asked to approve a revised proposal at its December 2012 meeting, the CAG should receive a copy of the revised proposal at the same time as the IESBA. Mr. Koktvedgaard asked that a feedback statement, in the style of that prepared by the IAASB, to be provided to the CAG.

D. Review of Part C

Mr. Gaa introduced the topic, noting that at its February 2012 meeting the IESBA had agreed to consider whether Part C of the Code addressing PAIBs should be strengthened. A working group, including two PAIBs with large and small business experience, had been set up to explore matters that could inform the development of IESBA's strategy and work plan for 2014-16 in this area. The working group had conducted a survey of IFAC member bodies with large numbers of PAIBs and had identified the following issues as potential priorities:

- Responsibility to produce truthful information and reports
- Pressure from superiors to engage in unethical or illegal acts ("pressure")
- Requirement to disassociate from misleading information
- Specific guidance relevant to professional accountants in the public sector
- Facilitation payments and bribes (inducements offered and received)
- Conflicting business partner vs. controller roles
- Independence requirements for professional accountants who are not in public practice who perform assurance engagements
- Advocacy threats to fundamental principles
- Applicability of Part C to professional accountants in public practice

CAG representatives commented as follows:

- Messrs. Morris, Pannier and Peyret supported addressing "pressure." Mr. Morris was of the view that the pressure can be even greater when the CFO is not a professional accountant, which is increasingly the case. Mr. Peyret expressed the view that companies should have strong internal policies that provide a "guarantee of fair treatment" for those who withstand inappropriate pressure. Mr. Fleck commented that there is an additional challenge for PAIBs as they work in an environment in which the Code cannot be enforced.
- Mr. Pannier also supported "faithful representation" as a priority. He questioned why "facilitation payments" was not a higher priority. Also, he noted that there is already a requirement for internal auditors to be independent.
- Mr. Johnson commented that Part C is a difficult area and it is bigger than practice. He noted that in many jurisdictions, accountants are not PAIBs. He expressed support for "not being associated with misleading information." He cautioned against guidance on "earnings management" as it is difficult to define what is "improper." He also questioned whether committing resources in examining aggressive earnings management would be fruitful. He noted that there is already guidance on whistleblowing in many companies and it may be sufficient to just refer to that guidance. He also commented that because of the sovereign debt crisis, "public sector" should be included.
- Ms. Lang supported the comments made by Mr. Johnson in relation to "earnings management," echoing his comments in relation to how one would determine what "improper" earnings management would be. She thought that this would be a challenging project for the IESBA but did agree that PAIBs should not be be associated with misleading information. She further observed, in response to Mr. Johnson's comments, that PAIBs are often distant from their professional bodies, even when they are members of those professional bodies. It seemed therefore important to ascertain whether the IFAC members had answered the survey questions on behalf of the PAIBs or whether they were quoting actual PAIB observations in their responses. She felt that it would be of merit to be clear on who the survey respondents were when considering the survey results given that these results were to be used as a foundation for the project. She expressed suppport for the inclusion of PAIB members in the task force, in particular

a PAIB of an SME. She also referred to the fact that in a sigincant number of cases, SMPs often act as PAIBs for SMEs and this may be worthy of consideration.

- Mr. Waldron commented that the priorities appeared about right. He expressed support for including "earnings management." Mr. Grund expressed interest in "earnings management" but advised that the Code could not be used to resolve problems in financial management.
- Mr. Fleck noted that earnings management had been looked at in 1998 but it presented challenges. Part C could say what constitutes impropriety. It would be necessary to find language that distinguished amongst judgment, manipulation and consideration of the motives behind the preparation of financial statements.
- Mr. Ratnayake expressed support for the suggested priorities.
- Messrs. Bradbury and Fleck supported Mr. Johnson's comments on the public sector. Mr. Bradbury questioned whether it should be a separate project or a separate section of the Code.
- Mr. Pannier asked if aggressive tax planning, e.g. transfer pricing, would be included under earnings management.

Mr. Fleck concluded that there was support for a project on Part C but asked that the IESBA consider the representatives' comments in developing a way forward.

E. Strengthening Safeguards Against Familiarity threats

Mr. Holmquist introduced the topic, outlining the background to the work stream, including related developments in Europe with the EC's issuance in October 2010 of its green paper, *Audit Policy: Lessons from the Crisis*, and in the U.S. with the PCAOB's issuance in August 2011 of its concept release on auditor independence and audit firm rotation ("concept release"). He also summarized the discussion on the topic at the June 2012 IESBA meeting.

Mr. Baumann gave an update on the PCAOB's activities related to the issuance of its concept release. In particular, he noted that the PCAOB was continuing to reach out to stakeholders through channels such as roundtables to find out what can be learned from them on the topic. Such outreach would continue into 2013. The PCAOB had not made a decision on the way forward until it has gathered all the necessary information and completed its outreach.

Representatives commented as follows:

- Mr. Hansen was of the view that IFAC has a role to play in relation to this topic. Regarding the issue of market concentration, he was of the view that the focus should be on audit quality and not market concentration. In relation to the topic of mandatory firm rotation, he noted that some of the discussion of the pros and cons could be misleading. For example, he questioned from whose perspective the issue of increased cost should be viewed. He felt that this should be from the perspective of the investor and not the firm.
- Ms. de Beer was of the view that it did not reflect well on the IESBA not to have an active project given the policy debates in Europe and the U.S. She felt that compared with the IAASB, which has been more actively involved in the debate via its auditor reporting project, the IESBA seemed to be taking a more passive approach in terms of waiting for EC and PCAOB developments. She questioned whether it was right for the IESBA to focus on partner rotation, believing that its current approach to the issues being debated internationally seemed to lack substance. Mr. Holmquist noted that the IESBA did look at research into mandatory firm rotation but there was

insubstantial evidence from which to draw conclusions. He felt that the debate was political. Ms. de Beer commented that the difficulty with the academic studies is that the field is narrow given that not many jurisdictions have mandatory firm rotation. She was of the view that the IESBA could be more proactive in researching the issue, much as the IAASB had commissioned academic studies on auditor reporting and the PCAOB has been undertaking outreach in relation to its concept release.

- Mr. Johnson disagreed with Ms. de Beer. He was of the view that now was the right time to be considering the specific issue of partner rotation, given the wide variation in national requirements. He noted that if the ambition is for the Code to be international, there would need to be clarity on this particular topic. He was of the view that the larger firms are making judgments in this area when it would be better for the Code to specify the requirements. Accordingly, he felt that there was a need to consider the issue of partner rotation periods. He also felt that there was a need to address the question of who should be in the scope of the internal rotation requirements. He did not believe that the Code should address the issues of mandatory firm rotation and mandatory tendering as these matters should be dealt with by regulators. He was of the view that as adoption of the Code is already quite low in the EU (only nine countries), there would be a risk that adoption would further decrease with a consequential increase in regulation if the IESBA sought to address mandatory firm rotation. He questioned the utility of undertaking further research if the Code would not address the output of it as the IESBA should not regulate this, noting also the importance of understanding the objective of such research.
- Mr. Fleck noted that the Planning Committee felt that the Code's requirement for partner rotation needed to be reconsidered, especially as it could permit a key audit partner to be involved in the audit for a client for 14 out of 16 consecutive years. He felt there was a difference in addressing this type of straightforward issue vs. tackling a highly controversial topic such as mandatory firm rotation.
- Mr. Pannier felt, like Ms. de Beer, that there was an issue of perception. Given the impact of the EC's green paper, he wondered whether the IESBA could seek to develop a position paper or similar document on the issues. He was of the view that the core of such a document could be partner rotation but acknowledged that there would be a need to understand what other documents could be developed with respect to mandatory firm rotation and mandatory tendering. He suggested that rather than establishing standards on the latter two topics, these documents could set out IESBA positions on them.
- Mr. Baumannn noted that the Code deals with threats to audit quality through addressing a key audit partner's long association with an audit client. He wondered what the impact on audit quality would be with respect to a firm's long association with an audit client. Accordingly, he questioned whether the Code should not also address this issue. He agreed with Ms. de Beer regarding the topic of auditor reporting, noting that the profession had received high marks for being engaged on this particular topic and for being responsive to investor concerns. He was of the view that it would be appropriate for the IESBA to be involved in the debate on long tenure without prejudging what the solutions might be. Ms. de Beer clarified that she felt the IESBA should be part of the debate, as its current approach on the issue of mandatory firm rotation seemed insubstantial.
- Mr. Morris noted that if the IESBA were to explore the issue of mandatory firm rotation, it would need to look at the issue of actual cost from the perspectives of both the entity and the public. He

was of the view that mandatory firm rotation will be costly and that the cost could be larger than participants in the debate might be willing to acknowledge. Mr. Hansen commented that if IFAC wishes to be involved in the debate, it should have a position on the issues that would be defensible. He agreed with Mr. Morris that mandatory firm rotation can be very costly. He added, however, that it would be important to also consider the benefits, so the relevant factor to consider would be the net benefits.

- Mr. Thorpe noted that while he supported mandatory tendering, he was not persuaded that it was an issue for the IESBA to address. He was of the view that it would be for the client or the regulator to decide.
- Mr. Ratnayake noted that one aspect that would need consideration is audit firms' reliance on fees from their audit clients, which creates a threat to independence. With mandatory firm rotation, a firm could be the auditor for a client for only a limited period, which would mitigate the threat to independence. He also highlighted the situation where a firm might be motivated not to express a modified opinion on the current year financial statements for a client if the firm realized that the opinion it had expressed on the previous year's financial statements was incorrect. He noted that in this situation, the prior decision creates a threat to independence that would not be addressed by partner rotation but which could be dealt with by firm rotation.
- Mr. Grund commented that it was unclear what Ms. de Beer intended. He noted that the agenda paper had already indicated that the IESBA would be taking some action and he wondered whether this would go far enough for Ms. de Beer. Mr. Fleck noted that there are two factors that have influenced the IESBA's discussions regarding the direction to take. Firstly, having regard to the PCAOB's work, the IESBA's view has been that it would not be able to add further to the sum total of knowledge on the topic through further research. And secondly, the IESBA has been concerned with what would be the right course of action for a global code, rather than react to what the EC might decide to do for the 27 EU member states or what the PCAOB might decide to do for the U.S. Accordingly, the IESBA has felt the need to consider the broader perspective rather than try to duplicate the work being done in specific jurisdictions. He added, however, that he would not dispute Mr. Baumann's concern as to whether long tenure with an audit client creates a threat to independence.
- Ms. de Beer agreed that this is the question the IESBA should be addressing. She was concerned that the IESBA seemed to have pre-empted an answer without having done sufficient work on the issues. Mr. Hansen agreed. Mr. Holmquist acknowledged Ms. de Beer's concern and recognized the potential reputational implication for the IESBA of not having devoted sufficient attention to the issues. However, he highlighted the IESBA's limited resources and the need to progress other projects of high priority. Accordingly, he questioned whether it would be the best use of those limited resources to focus on a particular topic because of a worry about a reputational effect. However, he noted that the IESBA could reflect on the matter if the CAG felt strongly about it. Ms. de Beer noted that an alternative would be to ask what would be in the public interest and that should drive where resources should be deployed.
- Mr. Johnson agreed with Mr. Holmquist, noting that the resource issue is very significant. He expressed a preference for resources to be devoted to adoption of the Code, noting that extensive research has already been, or was being, undertaken by others on the issues of market concentration and choice. He noted his strong concern if the IESBA were to seek to step into the regulatory space, and his strong views as to the best use of the IESBA's resources.

Messrs. Fleck and Holmquist noted that representatives' comments would be taken back for further reflection. Mr. Fleck concluded the session, noting the importance of not duplicating work done by others.

F. Reformat of the Code

Mr. Holmquist introduced the topic, noting that concerns had been heard from stakeholders about the Code not being easy to read and understand, a view shared by some IESBA members. Accordingly, the issue was how to reformat the Code to enhance its readability and accessibility. The topic was discussed at the February and June 2012 IESBA meetings, as well as at the IESBA Planning Committee, and there was support for moving forward on the initiative. The Planning Committee was conscious that changes to the Code can be costly not only in terms of IESBA staff resources needed but also for jurisdictions that have to adopt and implement them in terms of translation, education, training, etc. Accordingly, a thorough analysis of the options and their advantages and disadvantages would be important. He noted that the Planning Committee would be exploring both short term and long term options in this regard.

Mr. Fleck noted that a total reformat of the Code would involve changes to wording, which could raise questions such as the need for consultation and whether there would be changes to intended meaning. Accordingly, the Planning Committee had expressed support for an exercise to be undertaken that would test whether the Code's requirements and prohibitions could be given greater visibility.

Ms. de Beer agreed with the Planning Committee view. She asked whether stakeholders would be consulted on the structure and format of the Code. She was of the view that it would be a mistake if the IESBA did not see a need for such consultation given that the Code is not widely adopted. Mr. Fleck commented that this was indeed the intention once options have been identified and the pros and cons analyzed. Mr. Holmquist concurred, noting that consultation would be necessary if the decision on a particular direction would be for the long term.

Mr. Fleck noted that the Planning Committee had discussed identifying more than one option. He added that the UK code is more granular than the IESBA Code in that the IESBA Code does not address who should apply specific requirements. He observed that the UK approach has helped bring a focus on what individuals in firms should be doing. It has also led to ethics partners being identified in the larger firms to deal with ethics-related issues. Mr. Thorpe commented that every large firm has an ethics partner. Mr Johnson agreed, noting that this has not been an issue.

Ms. Blomme expressed support for a "bolding" approach. She noted that there had been prior IESBA consideration of applying the approach the IAASB had taken in its clarity project. The thinking now seemed to be for a more moderate approach. However, there were lessons to take into account in developing a way forward. She added that there was a need to be clear as to what the lack of clarity was about.

Ms. Lang was of the view that some reformatting of the Code would help SMPs. She concurred with the need for outreach and consultation on the initiative. In relation to the longer term view, she noted the importance of a cost-benefit analysis of reformatting the Code. At the same time, it would be important to know who has adopted the Code. She also advocated a building blocks approach which would help SMPs understand their ethical responsibilities. Mr Homquist asked Ms. Lang if she felt that SMEs/SMPs would favor two codes (i.e. a separate SME/SMP code) or one code. Ms. Lang stated that one Code would be preferable if developed and written in a "Think Small First" or Building Blocks approach. The

basic principles for all could then be laid out, and complexity could be added to the Code in building blocks.

Mr. Fleck concluded the session, noting that a further update on this initiative would be provided at the next CAG meeting.

G. Breach of a Requirement of the Code

Ms. Munro introduced the topic, summarizing the outcome of the IESBA discussion of the topic at its June 2012 meeting. She noted that subject to the CAG discussion of the topic at this meeting, the Task Force planned to seek final approval of the proposals at the October 15, 2012 IESBA teleconference. To facilitate this, the IESBA had, at its June 2012 meeting, taken a straw poll indicating that subject to additional changes in response to comments from CAG members, the IESBA would support issuing the document in final form. She then briefly recapitulated the significant issues arising on exposure and the Task Force's responses thereto.

Mr. James noted that one of IOSCO's concerns with respect to independence provisions has been the resign-first mentality. He wondered about the IESBA's thought process as to whether the concept of resignation should apply also to other aspects of the Code outside of independence. Ms. Munro noted that a distinction exists. For an audit engagement, independence is essential. Accordingly, a breach of the Code's requirements with respect to independence would make it difficult for the auditor to continue the engagement. In contrast, it would be unclear what a "resign first" mindset would mean in relation to a breach of other requirements of the Code by, for example, a professional accountant in business. She noted that for this reason, the IESBA did not believe that the concept of resignation should apply to a breach of a provision of the Code that does not relate to independence. Mr. Fleck emphasized that the IESBA had carefully considered the issue and had come to the view that the concept cannot be generalized throughout the Code. However, the IESBA was conscious of the need for a rigorous approach with respect to independence.

Ms. Blomme noted that the independence rules of the U.S. Securities and Exchange Commission (SEC) do not require reporting of certain breaches that are created where a family member of a covered person has a financial interest in an audit client. She questioned whether the IESBA had considered whether there should be a similar exemption from disclosure in the Code. Ms. Munro noted that the IESBA had considered this matter early in the project and concluded that all breaches of the Code should be reported. The IESBA recognized that this would go beyond the disclosure required under SEC independence requirements.

In relation to the firm's policies and procedures, Mr. James noted that the proposed documentation requirements do not call for documentation of the firm's conclusion that objectivity had not been compromised and the rationale for that conclusion. Ms. Munro noted that the documentation paragraph did not repeat all of the material which was contained in the paragraph detailing the matters to be discussed with those charged with governance because the IESBA wanted to avoid repetition within the standard. Mr. Fleck noted that one of the first matters to discuss with those charged with governance would be the significance of the breach. Ms. Munro suggested that it might be clearer if the requirement was to document "all" matters discussed with those charged with governance. Mr. James stated that this would be somewhat clearer.

Ms. Munro noted that IESBA was proposing changes to paragraph 290.47 to better target the firm's policies and procedures which would be discussed with those charged with governance.

Ms. Munro explained that the proposed revisions to paragraph 290.42 dealing with notification of a breach of a provision of the Code had been developed by the Task Force but had not yet been considered by the IESBA. She noted that the Task Force had developed this wording to respond to a comment from IOSCO that the firm's assessment and determination of the outcome of the breach should be elevated within the firm, for example, to the firm's quality control function and or the firm's leadership. The language developed is consistent with International Standard on Quality Control (ISQC) 1.[7] Mr. James noted that IOSCO continues to have a concern in the area of escalating a breach within the firm. He questioned at what level within the firm the matter would be addressed. Mr. Fleck stated that this would be addressed by ISQC 1.

Mr. Kuramochi stated that a significant concern for IOSCO is to ensure that, when a provision of the Code has been breached, the decision to continue an audit engagement be made at the firm, as opposed to the engagement partner, level. This is because of the significant pressure the engagement partner will experience to continue the engagement. Accordingly, IOSCO was of the view that there is a need to clarify the respective roles of the engagement partner, the firm's quality control department and the firm's leadership in this regard so that the firm can properly address the issue. Mr. Kuramochi noted that this issue relates not only to paragraph 290.42 but also to other paragraphs of the requirements for breaches. Mr. Fleck suggested that a refinement could be made to paragraph 290.42 to clarify that the communication should be made by the individual who has become aware of the breach.

Mr. Kuramochi also stated that it was unclear in paragraph 290.49 in relation to documentation, as well as in other parts of the section, whether the requirement was directed at the engagement partner or the firm. Ms. Munro noted that this issue had been discussed as part the IESBA's consideration of a possible reformatting of the Code and that it is not unique to this section. Pending the IESBA's further consideration of the reformatting of the Code, it would be necessary to retain the current construct. In relation to reporting, Mr. Kuramochi noted that several IOSCO members are of the view that transparency by firms to investors, in terms of disclosure of breaches in the auditor's report, is of great importance, a point that IOSCO had raised in its comment letter. He added that such reporting could be based on an appropriate threshold. Given that the IAASB is now progressing its Auditor Reporting project, some IOSCO members were of the view that the IESBA's project on breaches should be closely linked to the IAASB's project. Ms. Munro noted that the IESBA's view is that the matter of disclosure of beaches is for national regulators to decide, and that the IESBA did not believe the matter would be appropriate in a Code for general application.

Mr. Kuramochi highlighted that some IOSCO members have concerns on the above issues. He drew attention to the fact that pursuant to the recent Monitoring Group review of the IFAC reforms[8], an individual Monitoring Group member would expect direct feedback from the IESBA regarding the Monitoring Group member's input on a particular issue if it does not appear that the IESBA will take up the input in the final standard. He questioned if the IESBA has a plan to respond to IOSCO on this issue. Ms. Munro noted that she knew about this matter and was under the impression that a mechanism was being developed and, in the meantime, an oral response had been considered

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[7] ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

[8] 2003 IFAC Reform proposal states that "*Members of the MG will, if desired, comment on proposed standards. When they do so, the relevant IFAC standard setting board or committee should give strong consideration to such comments, and, if the comment is not to be taken up in the final standard, should explain to the relevant MG member the reasons for that decision.*"

appropriate. She indicated that she would follow up on the matter and respond accordingly. Mr. Kuramochi expressed his view that it would be important for IOSCO to receive direct feedback from the IESBA regarding the issue.

Mr. Fleck acknowledged that there are at least two main IOSCO issues that need to be addressed prior to finalizing the document. Mr. Fleck recommended that IOSCO and IESBA Staff resolve these outstanding issues subsequent to CAG meeting.

Regarding the effective date of the proposed changes to the Code, Mr. Fleck questioned whether early adoption would be permitted. Ms. Munro expressed the view that this is a matter that the IESBA should consider at its October 15, 2012 teleconference.

H. PIOB Observer's Remarks

Mr. Hafeman congratulated the CAG on a productive meeting, noting that the meeting was well-organized and effectively chaired. He commented that the PIOB highly values the role of the CAGs and appreciates the commitment of representatives and their organizations to contribute to the standard-setting process. He added that as an advisory group, representatives' participation is very important. Accordingly, those who were less active during the discussions were encouraged to speak up more at future meetings.

Mr. Hafeman also noted that the input representatives had provided to the IESBA should be useful. Amongst other matters, this input highlighted several important issues, the resolution of which might be subject to specific ongoing monitoring by the PIOB.

Mr. Hafeman then reported that the PIOB would be meeting later this week. Items on the agenda included analyzing the results of the recent PIOB-MG public consultations and considering the approval of several standards and other matters, including the process for the succession of Mr. Fleck as chair of the IESBA CAG. He encouraged representatives to consider stepping forward as candidates for this key role.

Mr. Fleck thanked Mr. Hafeman for his remarks.

I. Closing Remarks

Mr. Fleck thanked all representatives for their participation. He also thanked Ms. Munro for her tremendous contribution to the IESBA's work over the years and conveyed his best wishes to her in her future endeavors. He then closed the meeting.