

Definition of Those Charged With Governance

Background

1. At its February 2012 meeting, the IESBA discussed responses to the Exposure Draft (ED), *Proposed Changes to the Code of Ethics for Professional Accountants Related to Provisions Addressing a Breach of a Requirement of the Code*. Amongst the responses, the IESBA noted a comment from a respondent that the Code's definition of "those charged with governance" is not consistent with the definition of the same term in ISA 260.¹ The ISA definition is as follows:

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

2. The IESBA considered the ISA definition and concluded that the communications required under the Code should be to the same group of people as the communications required under ISA 260. The IESBA therefore agreed to undertake a separate project to seek to more closely align the Code's definition of "those charged with governance" with that contained in the ISA.
3. In July 2012, the IESBA issued an exposure draft (ED) of the proposed revised definition, aligned with the ISA definition except for the last sentence which is specific to ISA 260:

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

4. The proposed revised definition captures essentially the same group of people as captured by the current definition in the Code. The IESBA also proposed changes to paragraph 290.28 to recognize that the communication may be with a subgroup of those charged with governance.
5. In addition, the IESBA proposed that in each instance where the Code refers to communication to "those charged with governance," the wording is changed to "those charged with governance or a subgroup thereof." This change was intended to reflect application guidance in ISA 260, as well as common practice, by recognizing that a subgroup of those charged with governance may be the appropriate person(s) within the entity's governance structure with whom to communicate.
6. At its March 2013 meeting, the IESBA considered the significant comments received on the ED and agreed on a number of responses as described below.

Overview of Responses

7. The comment period for the ED closed on October 31, 2012. Thirty four responses were received. The Appendix provides a detailed listing of the respondents.

¹ ISA 260, *Communication with Those Charged with Governance*

8. None of the respondents fundamentally disagreed with the proposed definition or with the objective of aligning the definition with that in ISA 260. However, a number of suggestions were made as to how the proposal could be improved. The significant comments are summarized below, grouped into the following categories:
- Definition of “management;”
 - References to “or a subgroup thereof;” and
 - Need for additional guidance on the meaning of those charged with governance.

Significant Comments Arising from the ED

A. DEFINITION OF “MANAGEMENT”

9. Some respondents² suggested that the term “management” be defined. It was noted that the term is defined in ISA 260 and that introducing a term within the Code that may be subject to variable interpretation should be defined.
10. ISA 260 defines “management” as:
- “The person(s) with executive responsibility for the conduct of the entity’s operations. For some entities in some jurisdictions, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner-manager.”

IESBA’s Response

11. The term “management” is currently used throughout the Code in areas directly related to the definition of “those charged with governance” as well as in other aspects.
12. The IESBA took the view that if a definition of the term “management” were to be considered for inclusion within the Code, the implications of doing so would need to be considered, both in relation to the use of the term regarding issues pertaining to the definition of “those charged with governance” and in all other instances in which the term “management” is used throughout the Code.
13. As a consideration of matters other than those directly pertaining to the definition of “those charged with governance” is beyond the scope of this project and the term is currently being interpreted and applied in practice without reports of significant issues, the IESBA did not believe that it should undertake to define the term “management” for purposes of the Code at this time.

Matter for CAG Consideration

1. Do representatives agree with the IESBA?

B. REFERENCES TO “OR A SUBGROUP THEREOF”

14. Many respondents³ expressed concern with the proposal to add references to “or a subgroup thereof” throughout the Code wherever the term “those charged with governance” is used. Key points raised include the following:

² Member bodies: ACCA, IDW, WPK; other organizations: Assirevi, FEE, IRBA

- Including these references throughout the Code does not necessarily result in better alignment with the IAASB Handbook. ISA 260 considers communication with a subgroup of those charged with governance to be appropriate in some, but not necessarily all instances.
- Including a reference to “or a subgroup thereof” may detract from the central message concerning communication, and make it less easy for professional accountants to engage with the Code. It could potentially invoke a casual approach by professional accountants in choosing with which subgroup to communicate.
- The references to “or a subgroup thereof” need to be considered with specific reasoning relevant to the independence environment. The references would, amongst other things, result in the requirements of internal audit activities, including the review, assessment and approval of the scope, risk and frequency of the internal audit service, being set by a subgroup (290.195).
- Paragraph 290.28 provides a comprehensive explanation as to what constitutes communicating to “those charged with governance.” Hence, the references to a subgroup thereof should not be repeated throughout the Code.
- The IESBA should consider whether to incorporate a cross reference in paragraph 290.28 of the Code to the application material in ISA 260 (A1-A8) or a general reference to ISA 260.

IESBA’s Response

15. The IESBA acknowledged the practical issues raised by the respondents. To address these concerns, the IESBA considered modifying:
 - Each proposed reference to “or a sub-group thereof” as appropriate to ensure consistency with the guidance in ISA 260;
 - The definition of “those charged with governance” through an addendum that makes reference to “or a subgroup thereof” in the context of communication with those charged with governance, thereby eliminating the need to include the phrase throughout the Code; or
 - Section 100⁴ through the addition of an overarching provision, applicable to the entire Code, that would effectively explain that communication with those charged with governance may be with a subgroup of them.
16. The first option would entail the IESBA making changes that would not necessarily be consistent with a principles-based approach. The resulting modifications could potentially be deemed significant and would likely utilize the most resources to make operational.
17. While the second option would eliminate the duplication that arises from including the reference to “a subgroup thereof” throughout the Code, the IESBA rejected that option as it would not only introduce, in effect, guidance through a definition, but also result in a definition that could be seen as substantially different from what was exposed.

³ Regulator: CARB; member bodies: ACCA, CND-CEC, CPA Australia, ICAA, IDW, SAICA, WPK; firms: EYG, KPMG, PwC; other organizations: Assirevi, IRBA, NASBA; others: Anonymous

⁴ Section 100, *Introduction and Fundamental Principles*

18. The IESBA agreed in principle on the third option. This option has the practical advantage in that the overarching provision that would be added to Section 100 would be applicable to professional accountants in all circumstances where communication with those charged with governance is envisaged in the Code. This provision would parallel the principle proposed to be added to paragraph 290.28 as set out in the exposure draft, and would read as follows:

Communicating with Those Charged with Governance

100.25 When communicating with those charged with governance in accordance with the provisions of this Code, the professional accountant or firm shall determine, having regard to the nature and importance of the particular circumstances and matter to be communicated, the appropriate person(s) within the entity's governance structure with whom to communicate. If the firm communicates with a subgroup of those charged with governance, for example, an audit committee or an individual, the professional accountant or firm shall determine whether communication with all of those charged with governance is also necessary so that they are adequately informed.

Matter for CAG Consideration

2. Do representatives agree with the IESBA's decision to go with the third option as described above?

C. NEED FOR ADDITIONAL GUIDANCE ON THE MEANING OF THOSE CHARGED WITH GOVERNANCE

19. Several respondents⁵ suggested that additional guidance on the meaning of those charged with governance, such as the application material included in paragraphs A1-A8 and A13 of ISA 260 (see Agenda Item F-3), should also be included within the Code. Some respondents suggested that this could be achieved either by including additional explanatory material within the Code, or incorporating by reference the application material currently included within ISA 260. Amongst other things, respondents noted that the Code is applied in a variety of situations and in different jurisdictions – both in business and practice. They therefore argued that the definition should be made as clear as possible.

IESBA's Response

20. The IESBA noted that the primary objective of this project is to achieve better alignment between the Code and the ISAs regarding the definition of the term “those charged with governance.” The project is intended to address a specific concern raised within the context of the Breaches project, i.e., that the communications required under the Code should be to the same group of people as the communications under ISA 260.
21. The proposed definition is fundamentally the same as the existing definition within the Code, with the addition of wording to align the definition in the Code with that in ISA 260. Prior to the issuance of this ED, the IESBA had not received feedback on significant issues in practice that would suggest a need for more detailed guidance on applying the term “those charged with governance.”
22. Further, while ISA 260 includes useful guidance on applying the definition of those charged with governance, the context within which the guidance is provided differs from the context within which the Code is written. The former is written in the context of the auditor's responsibility to

⁵ Member bodies: ACCA, CPA Australia, HKICPA, IDW; other organizations: APESB, FEE, NASBA

communicate with those charged with governance, while the Code covers a broader set of relationships between professional accountants in practice and in business and those charged with governance.

23. The IESBA therefore agreed that it would not be appropriate for this project to attempt to develop detailed guidance on the meaning of the concept of “those charged with governance” for inclusion in the Code, or for the guidance within ISA 260 to be incorporated by reference within the Code.

Matter for CAG Consideration

3. Do representatives agree with the IESBA?

Appendix

LIST OF RESPONDENTS <i>Proposed Change to the Definition of "Those Charged with Governance"</i>	
Abbreviation	Organization
MEMBER BODIES	
ACCA	The Association of Chartered Certified Accountants
AICPA	American Institute of CPA
CGA	Certified General Accountants Association of Canada
CICA	The Canadian Institute of Chartered Accountants
CNDCEC	Consiglio Nazionale dei Dottori Commercialisti + E Degli Esperti Contabili
CPA Au	CPA Australia
HKICPA	Hong Kong Institute of Certified Public Accountants
IBRACON	Instituto dos Auditores Independentes do Brasil
ICAA	The Institute of Chartered Accountants in Australia
ICAEW	The Institute of Chartered Accountants in England and Wales
ICAI-India	The Institute of Chartered Accountants of India
ICAP	Institute of Chartered Accountants of Pakistan
ICAS	The Institute of Chartered Accountants of Scotland
ICPAS	Institute of Certified Public Accountants of Singapore
ICPAU	Institute of Certified Public Accountants of Uganda
IDW	Institut der Wirtschaftsprüfer
KICPA	Korean Institute of Certified Public Accountants
SAICA	The South African Institute of Chartered Accountants
WPK	Wirtschaftsprüferkammer
FIRMS	
DTT	Deloitte Touche Tohmatsu
EYG	Ernst & Young Global
GTI	Grant Thornton International
KPMG	KPMG
PwC	PricewaterhouseCoopers
RSM	RSM International
REGULATORS & PUBLIC AUTHORITIES	
CARB	Chartered Accountants Regulatory Board
IRBA	Independent Regulatory Board for Auditors
NATIONAL STANDARD SETTERS	
APESB	Accounting Professional & Ethical Standards Board Limited-Australia

LIST OF RESPONDENTS
Proposed Change to the Definition of "Those Charged with Governance"

Abbreviation	Organization
NZAuASB	New Zealand Auditing and Assurance Standards Board
OTHER PROFESSIONAL ORGANIZATIONS	
ASSIREVI	ASSIREVI - Italy
FEE	Fédération des Experts Comptables Européens
NASBA	National Association of State Boards of Accountancy
INDIVIDUALS & OTHERS	
Anonymous	Trinidad and Tobago
Denise Juvenal	Denise Silva Ferreira Juvenal