

Basis for Conclusions
Prepared by the Staff of the IESBA
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*International Ethics Standards Board for
Accountants*

**Change to the Definition of
“Those Charged with
Governance” in, and Related
Changes to, the Code of
Ethics for Professional
Accountants**

IESBA

**International
Ethics Standards
Board for Accountants™**

This document was prepared by the Staff of the International Ethics Standards Board for Accountants (IESBA).

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BASIS FOR CONCLUSIONS: CHANGE TO THE DEFINITION OF “THOSE CHARGED WITH GOVERNANCE” IN, AND RELATED CHANGES TO, THE CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

This Basis for Conclusions has been prepared by staff of the International Ethics Standards Board for Accountants (IESBA). It relates to, but does not form part of, the change to the definition of “those charged with governance” in, and related changes to, the Code of Ethics for Professional Accountants (the Code). These changes were approved by the IESBA in June 2013 with the affirmative votes of 15 out of 15 IESBA members present.

Background

1. The IESBA initiated a project to revise the definition of the term “those charged with governance” in the Code in response to a comment arising on its October 2011 exposure draft addressing a breach of a requirement of the Code. This comment noted that the Code’s definition of the term is not consistent with the definition contained in International Standard on Auditing (ISA) 260.¹ Given this inconsistency, there was potential for uncertainty as to whether the communications to those charged with governance required under the Code should be made to the same group of people as envisaged by ISA 260.
2. The IESBA affirmed that the communications to those charged with governance under the Code are intended to be to the same people as under ISA 260. Accordingly, to avoid any perception that the Code and the ISAs are in conflict, the IESBA determined that the definition of “those charged with governance” in the Code should be aligned with that in ISA 260.
3. The IESBA issued an exposure draft (ED) of the proposed change to the definition of “those charged with governance” in, and related changes to, the Code in July 2012.
4. The comment period for the ED closed on October 31, 2012. Thirty four responses were received from various respondents, including regulators and public authorities, national standard setters, IFAC member bodies, other professional organizations, and firms. While the overwhelming majority of the respondents were supportive of the IESBA’s proposals in the ED, a minority had concerns with certain aspects of the proposals, as described below.
5. The IESBA discussed this project with the IESBA Consultative Advisory Group in April 2013.

Definition of “Management”

6. The ED proposed that the definition of “those charged with governance” in the Code be amended 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.

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

7. Some respondents to the ED suggested that the term “management” be defined in the Code. It was noted that including within a definition a term that may not be capable of consistent interpretation without defining that term is not helpful and will not aid consistent application of the Code. It was therefore suggested that the definition of the term “management” from ISA 260 be added to the Definitions section of the Code.

IESBA Decision

8. The IESBA determined that a consideration of matters other than those pertaining directly to the definition of “those charged with governance” would be beyond the scope of this project. It noted that the term “management” is currently used throughout the Code and is being interpreted and applied in practice without reports of significant issues with its use. Accordingly, the IESBA did not believe that it would be appropriate to amend the Code to include a definition of “management” as part of this project.
9. The IESBA has nevertheless noted whether to develop such a definition for the Code as a matter for future consideration.

Reference to “or a Subgroup Thereof”

10. A number of respondents expressed concern with the proposal in the ED to add references to “or a subgroup thereof” throughout the Code wherever the term “those charged with governance” is used. Amongst the arguments raised were the following:
 - Including these references throughout the Code does not necessarily result in better alignment with the ISAs. 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.

IESBA Decisions

11. The IESBA acknowledged the practical issues raised by the respondents and agreed to remove the addition of the phrase “or a sub-group thereof” in the various places noted in the ED. Instead, the IESBA determined that the following paragraph should be added to Section 100² of the Code so

² Section 100, *Introduction and Fundamental Principles*

that the overarching principles in that paragraph would apply wherever the Code calls for a professional accountant or firm to communicate with those charged with governance:

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 professional accountant or 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.

12. Given the importance of communicating a breach of a requirement of the Code, particularly an independence requirement, to those charged with governance in the context of an audit engagement, the IESBA also determined that the proposed addition to paragraph 290.28 in the ED should be retained but aligned with the new paragraph 100.25:

In complying with requirements in this section to communicate with those charged with governance, the 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 firm shall determine whether communication with all of those charged with governance is also necessary so that they are adequately informed.

Need for Additional Guidance on the Meaning of Those Charged with Governance

13. Several respondents 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, should also be included in the Code. Some respondents suggested that this could be achieved by either 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 Decision

14. The IESBA noted that the project was intended to address a specific concern raised in the context of the Breaches project, i.e., that the communications with those charged with governance required under the Code should be to the same group of people as the communications required under ISA 260. Prior to the issuance of the ED, the IESBA had not received feedback suggesting difficulty, and therefore the need for guidance, in applying the existing provisions in the Code relating to communications with those charged with governance.
15. Further, while ISA 260 includes useful guidance on applying the definition of "those charged with governance," the context within which that guidance is provided differs from the context within which the Code is written. The context for ISA 260 is the auditor's responsibility to communicate with those charged with governance in an audit of financial statements. The Code, however, covers

a broader set of relationships between professional accountants in practice and in business and those charged with governance.

16. The IESBA therefore determined that it would not be appropriate to include more detailed guidance regarding the concept of "those charged with governance" in the Code, or that the guidance within ISA 260 be incorporated by reference within the Code.

Reference to "Section" in Paragraph 290.28

17. A few respondents commented that the reference to "section" in the proposed addition to paragraph 290.28 should be replaced with a reference to the "Code," as communication with those charged with governance is not solely contemplated in the context of Section 290, but also in other sections of the Code.

IESBA Decision

18. The IESBA determined that the reference to "section" in paragraph 290.28 is necessary because the addition to that paragraph was intended to apply in the context of Section 290. The IESBA believes that the addition of the overarching principles in paragraph 100.25 as described above addresses the respondents' concern that the communication considerations added to paragraph 290.28 should apply to other sections of the Code.

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