

International Ethics Standards Board for Accountants (IESBA)
CONSULTATIVE ADVISORY GROUP (CAG)

Draft Minutes

Held on September 14, 2011 Prague, Czech Republic

<i>Present:</i>	Richard Fleck (Chair)	Financial Reporting Council
	Matthew Waldron	CFA Institute
	Pat Sucher	International Association of Insurance Supervisors
	Kristian Koktvedgaard	Business Europe
	Amir Abadi Jusuf	Asian Financial Executives Institutes
	Federico Diomeda	European Federation of Accountants and Auditors for SMEs
	Jean-Luc Peyret	European Federation of Financial Executives' Institutes
	Hilde Blomme	Fédération des Experts Comptables Européens
	Matt Gamble	Gulf States Regulatory Authorities
	Margie Bastolla	Institute of Internal Auditors
	Markus Franz Grund	International Organization of Securities Commissions
	Nigel James	International Organization of Securities Commissions
	Koichiro Kuramochi	International Organization of Securities Commissions
	Filip Cassel	International Organization of Supreme Audit Institutions
	Gaylen Hansen	National Association of State Boards of Accountancy
	David Morris	North American Financial Executives Institute
	Dominique Pannier	Organisation for Economic Cooperation and Development
	Simon Bradbury	World Bank
	Linda de Beer	World Federation of Exchanges
	Giancarlo Attolini	IFAC SMP Committee
	Ken Dakdduk	IESBA Chair
	Robert Franchini	IESBA Member
	Michael Niehues	IESBA Deputy Chair
	Peter Hughes	IESBA Member
	Jan Munro	IESBA Deputy Director
	Chandrashekhar Bhawe	PIOB
<i>Regrets</i>	Marc Pickeur	Basel Committee on Banking Supervision

Conchita Manabat	Asian Financial Executives Institutes
Elena Lobanova	Graduate School of Financial Management, Russia
Paul Koster	Gulf States Regulatory Authorities
Obaid Saif Hamad Al Zaabi	Gulf States Regulatory Authorities
Gerald Edwards	Basel Committee on Banking Supervision
Georges Couvois	European Federation of Financial Executives' Institutes
Marie Lang	European Federation of Accountants and Auditors for SMEs
Philip Johnson	Fédération des Experts Comptables Européens
Martin Baumann	Public Company Accounting Oversight Board
Ajith Ratnayake	Sri Lanka Accounting and Auditing Standards Monitoring Board

A. Opening Remarks

Mr. Fleck welcomed all participants to the CAG meeting. He welcomed new CAG members Mr. Jusuf, Mr. Gamble, Mr. Grund, Ms. Sucher (now representing the International Association of Insurance Supervisors), and Mr. Attolini, deputy chair of the IFAC SMP Committee as an observer to the CAG. He also welcomed Mr. Bhave representing the Public Interest Oversight Board. He noted that apologies had been received from Mr. Pickeur, Ms. Manabat, Ms. Lobanova, Mr. Koster, Mr. Al Zaabi, Mr. Edwards, Mr. Couvois, Ms. Lang, Mr. Johnson, Mr. Baumann, and Mr. Ratnayake.

The minutes of the New York March 2011 CAG meeting were approved subject to some editorial changes.

Mr. Fleck noted that at the March 2011 meeting, after discussing the IESBA breaches project, CAG members had asked for the opportunity to comment on a revised draft before the IESBA approved the exposure draft at its June meeting. The draft that would be discussed at the June IESBA meeting had, therefore, been circulated to CAG members for comment before the June IESBA meeting. The IESBA was not asked to approve the document for exposure at its June meeting but expects that it will be asked to do so at its October meeting. He noted that the latest revised document was included in the agenda papers, thus providing CAG members with an additional opportunity to provide any comments before it is approved for exposure.

B. Report from IESBA Chair

Mr. Dakdduk reported that the IESBA had met twice since the last CAG meeting, once in June in Warsaw and then again by conference call in July.

Mr. Dakdduk provided an update on the IESBA activities since the last CAG meeting. In addition to the topics that were on the CAG agenda, the IESBA discussed its convergence initiative and was liaising closely with the IAASB on two of its projects – Revisions to ISA 610 *Using the Work of Internal Audit* and Revisions to ISRS 4410 *Compilations*.

Mr. Fleck noted that both projects had been discussed by the IAASB CAG at its meeting earlier in the week. He asked CAG members whether there were any ethical issues associated with either project which they wished to raise. The following comments were provided.

Compilations

Mr. Hansen expressed the view that he strongly believed that it was important for the compilation report to indicate whether the practitioner was independent. Mr. Pannier remarked that the practitioner could not be independent if the practitioner had performed the compilation. He noted that the needs of the users of a compilation are different and what is important is that the practitioner has integrity and performs the engagement with due care. In this regard it might be confusing for users if the report merely indicates that the practitioner was not independent.

Mr. Fleck indicated that the Institute of Chartered Accountants of England and Wales had conducted a survey to determine what users expected of practitioners. The results indicated that users expected the individual to have technical expertise and be “independent” in that they were not, for example, the spouse of the owner of the entity.

Mr. Morris expressed the view that the report should contain some statement about independence or objectivity and keeping silent on the matter did not seem to be appropriate. Mr. Cassel stated that it was important to be transparent. He noted that some state organizations are audited by a Supreme Audit Institution and the state organization needs some assistance with the preparation of its financial statements and so it might engage a firm to perform a compilation.

Ms. Blomme noted that practice varied from one jurisdiction to another – in some jurisdictions practitioners performing compilation engagements also perform bookkeeping functions, in other jurisdictions the practitioner performs no bookkeeping.

Mr. Koktvedgaard expressed the view that a practitioner was either independent or not. He noted that Section 290 only applied to assurance engagements and questioned why there should be a difference in independence depending upon the nature of the engagement.

Mr. Fleck stated that it seemed some clarity was called for. He noted that users were easily confused by whether an engagement was an audit or was not an audit – it was therefore, important that the report be clear. He noted that the UK APB was of the view that this needed to be addressed to avoid confusion.

Ms. de Beer asked whether there was a role for the IESBA in determining whether the compilation report should include a statement on independence and, if so, whether this should be communicated to the IAASB. Mr. Dakdduk responded that he believed it is not within the IESBA's purview to require a compilation report to state whether the practitioner is independent.

Mr. Diomeda noted that there had been some discussion as to whether a compilation engagement was an assurance engagement. He noted that it is not an assurance engagement under the assurance framework, but the fact that a competent accountant is performing the service does provide the user with some level of comfort.

Mr. Hansen said the language should be neutral. He noted that the AICPA reporting has evolved so that the accountant is able to state why he or she is not independent, whereas previously the report merely included a statement that the accountant was not independent without explaining why.

Mr. Koktvedgaard questioned how if the accountant's spouse owned the company the accountant could possibly be objective.

Mr. Cassel noted that the report should be structured to avoid confusion and that it was important to think about how an outsider would view the report.

Using the Work of Internal Audit

CAG members did not raise any ethical issues in relation to this project.

Other Matters

Mr. Dakdduk reported that the IESBA planned to respond to the PCAOB Concept Release on Auditor Independence and Firm Rotation. He noted that the IESBA had responded to the EU Green Paper.

Mr. Dakdduk reported that the IESBA was continuing with its outreach activities. He noted that there have been ongoing discussions with IOSCO, particularly with respect to the breaches project. He indicated that he would be meeting with IFIAR later in the month. The IESBA is of the view that this outreach is very important. Accordingly, Mr. Dakdduk may be contacting various other CAG member organizations. Those who would like to meet with IESBA members before then should let him or Ms. Munro know.

Mr. Dakdduk indicated that the IESBA Strategy and Work Plan has not been released as the PIOB has not yet completed its review of due process. He noted that the PIOB had commenced its review at its June meeting and had some questions. which he responded to. He anticipates that the PIOB will complete its review in September.

In concluding his remarks, Mr. Dakdduk noted that Mr. Niehues would be completing his term as an IESBA member at the end of the year. He thanked Mr. Niehues for his contribution and his support in the role of Deputy Chair.

C. Responding to a Suspected Illegal Act

Mr. Franchini, Task Force chair, introduced the topic. He noted that this project was discussed by the CAG at its March 2011 meeting and by the IESBA-National Standard Setters (IESBA-NSS) at its April meeting, and again by the IESBA at its June meeting. The Task Force has met twice since the June IESBA meeting and will meet once again before the October IESBA to consider input from CAG members and to finalize its proposals. It is anticipated that the proposals will be presented to the IESBA for approval as an exposure draft at its October 17th-19th meeting.

Mr. Franchini provided an overview of the proposed approach, noting that the IESBA is proposing two new sections dealing with responding to a suspected illegal act. Section 225 will apply to professional accountants in public practice and Section 360 will apply to professional accountants in business. The IESBA is also proposing some conforming changes to paragraph 100.21 and Section 140 *Confidentiality*. The IESBA also proposes to strengthen Section 210 in the area of client continuance decisions. The IESBA has developed a sequential approach to responding to a suspected illegal act for both Sections 225 and 310. There will be some differences in the approach between the two sections to reflect the differing circumstances faced by professional accountants in public practice and in business.

Section 225 will provide guidance for professional accountants who perform an audit or other professional service for an audit client of the firm, including a network firm. The guidance will provide the following for situations when information obtained in the course of providing the service leads the accountant to suspect that an illegal act has been committed:

- Require the professional accountant to make any disclosures required by law or regulation;
- Where disclosure is not required by law or legislation:
 - Require the accountant to take reasonable steps to confirm or dispel that suspicion;
 - If unable to dispel the suspicion, require the accountant to discuss the matter with the appropriate level of management and, if management's response is not appropriate, escalate it to higher levels of management and, if necessary, to those charged with governance;
 - If the response is still not appropriate, require the accountant to discuss the matter with those charged with governance;
 - If the response is still not appropriate, require the accountant to determine the appropriate course of action to take, including whether to terminate the professional relationship with the client;
 - If the accountant determines that disclosure of the suspected illegal act would be in the public interest and the client has not disclosed the matter, require the accountant to disclose the matter to an appropriate authority, when not prohibited by law. The matters to be reported are:
 - Suspected illegal acts that directly or indirectly affect the client's financial reporting; and

- Suspected illegal acts, the subject matter of which falls within the expertise of the professional accountant.
- In making the determination of whether disclosure would be in the public interest, the professional accountant is required to take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances, would be likely to conclude that the public interest is best served by disclosing the matter to an appropriate authority;
- If the accountant concludes disclosure is in the public interest, the accountant shall determine whether there is an appropriate authority to receive the disclosure.

Section 225 would require a similar sequential approach of escalation by an accountant providing a professional service to a client that is not an audit client. The approach does not, however, require the professional accountant to disclose the matter to an appropriate authority; rather, if the response to the matter is not appropriate, the accountant is required to disclose the matter to the external auditor of the entity. The auditor of the entity would then have the responsibility to take steps to confirm or dispel the suspicion, discuss with those charged with governance and, ultimately, if the auditor concludes that disclosure would be in the public interest and the entity has not disclosed the matter, disclose to an appropriate authority.

The approach to be taken in Section 360 for professional accountants in business would be similar to the approach to be taken for accountants in public practice providing professional services to an audit client. It provides that the accountant shall generally disclose the matter within the reporting lines of the employing organization. If the matter is not appropriately addressed, the accountant is required to report it to those charged with governance or the entity's external auditor. If the response to the matter is still not appropriate, the accountant shall determine the appropriate course of action, including whether to resign from the employing organization. If the accountant determines that disclosure of the suspected illegal act would be in the public interest and the entity has not disclosed the matter, the accountant would be required to disclose the matter to an appropriate authority, when not prohibited by law.

The Task Force has considered what responsibility a professional accountant should have to disclose a suspected illegal act to an appropriate authority if the accountant determines that disclosure would be in the public interest. The Task Force considered whether there should be a requirement/obligation to disclose or a right to disclose (i.e., if the accountant determined disclosure was appropriate, it would not be a violation of the confidentiality requirements of the Code if the accountant made the disclosure). The Task Force has also considered whether the obligation should be the same for all professional accountants.

Arguments in Favor of a Requirement

- As noted in the first paragraph of the Code, a distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. It is, therefore, appropriate to require a professional accountant to

disclose a suspected illegal act to an appropriate authority, if such disclosure would be in the public interest;

- Requiring disclosure will result in disclosure occurring more consistently in these situations than providing a right to disclose because there will be less discretion for the accountant to determine whether to disclose;
- A requirement will result in disclosure of more suspected illegal acts than would a right to disclose, which may have a deterrent effect thus potentially reducing the number of illegal acts; and
- The ultimate determination of whether it is in the public interest to take action should be made by an appropriate authority and not the professional accountant, it is therefore appropriate to require the accountant to disclose the matter to provide the authority with notification of the matter such that it can then investigate the matter further and determine whether action should be taken against those who committed the act.

Arguments in Favor of a Right

- Requirements to disclose illegal acts are normally established by law and are generally accompanied by regulations that afford protection from retaliation to those who make such disclosures. Such protective mechanisms can only be established by law and it is disproportionate to establish a requirement to disclose without also being able to establish such protective mechanisms.
- A requirement to disclose would be disproportionate in a country where there is uncertainty regarding the fairness of the judicial system. In such jurisdictions it would seem more proportionate for the professional accountant to have the discretion to disclose rather than a requirement.
- Requiring all professional accountants to disclose suspected illegal acts would be disproportionate when compared with existing legislation in many countries. Requirements to disclose illegal acts under anti-money laundering legislation or securities laws apply only to professional accountants in public practice and not professional accountants in business or other employees. For such latter categories of individuals, legislation normally establishes a right to disclose, rather than a requirement, coupled with whistle-blowing protection mechanisms and, occasionally, incentives to disclose.
- The accountant may not have access to all the information needed to be able to confirm the suspicion to the level necessary to require disclosure and a requirement may lead to an increase in disclosures of a frivolous nature.

The Task Force concluded that a professional accountant in public practice providing professional services to an audit client and a professional accountant in business should both be required to disclose a suspected illegal act to an appropriate authority, when disclosure would be in the public interest. A professional accountant in practice providing services to a non-audit client would not, however, be required to disclose the matter to an appropriate authority. Such an accountant might not have access to enough information within the company, or to the appropriate level of management, to be able to confirm or dispel the suspicion. The proposals would, therefore, require these accountants to disclose the matter to the entity's external auditor – who would then be required to confirm or

dispel the suspicion and, ultimately, if the matter is not appropriately addressed disclose the matter to an appropriate authority.

To address the concern that there may not be an appropriate authority to disclose the matter to, the Task Force proposes that the guidance state:

If the professional accountant concludes that such disclosure is appropriate, the professional accountant shall determine whether there is an appropriate authority to receive the disclosure and disclose the matter to the authority.

Unethical Acts that are not Illegal

Mr. Franchini noted that these matters would not be addressed in Sections 225 and 360; rather, the matters would be addressed through the paragraphs dealing with ethical conflict resolution (100.12 – 100.22).

Mr. Fleck expressed the view that the paragraphs as currently drafted did not seem to adequately address the issue. He noted that it was important to consider the reputational risk to the profession, if a professional accountant was associated with unethical behavior.

Mr. Pannier expressed support for the proposed approach noting that it was appropriate not to deal with unethical acts in the two sections dealing with illegal acts. He indicated that it was appropriate to limit the exposure of the professional accountant. Mr. Peyret noted that he was aware of a case where a professional accountant in a company that was in financial distress, upon the instruction of a superior in the company, wired company funds off-shore. The Court held that the accountant should not have taken this action, even though the accountant's superior had instructed the accountant to transfer the funds.

Mr. Hansen noted that if information comes to the attention of a professional accountant that leads the accountant to suspect an illegal act, not within the definition, has occurred, then intuitively there should be an obligation to report the act to someone.

Mr. Hansen questioned whether the third party test should require the professional accountant to weigh "all the *relevant* facts and circumstances." Mr. Franchini noted that the test had been summarized on the slide and the exact language, which was consistent with the acceptable level definition in the Code was "weighing all the *specific* facts and circumstances."

Response of a professional accountant providing non-assurance services

Mr. Hansen expressed the view that having a different test for professional accountants in public practice providing services to non-audit clients seemed to complicate matters and did not resonate with him. Mr. Fleck noted that this approach had been taken because a professional accountant providing a minor non-audit service might not have the opportunity to take many steps to confirm or dispel the suspicion, whereas an auditor would have this ability. He expressed his personal view that it would be preferable if the test was tied to the accountant's ability to investigate the matter further.

Mr. Hansen noted that in considering whether the accountant should have a responsibility or a right to disclose, his instinct indicated that it should be a responsibility but, after considering the advantages and disadvantages laid out in the paper, it would probably be better as a right.

Ms. Bastolla noted a professional accountant in public practice providing a professional service to a non-audit client could also report the matter to the internal auditor.

Mr. Morris stated that the approach proposed by Mr. Fleck seemed to be sensible. He noted that the services provided by a professional accountant to a non-audit client could be taxation services. There are a defined set of rules against which tax can be judged. It did not seem to be appropriate in such a circumstance for a professional accountant who knew about the issue not to report it to the tax authority, but rather just to report it to the external auditor.

Mr. Diomeda noted that it was important to consider those entities that did not have an external auditor. If there is no auditor, the professional accountant should be required to report directly to an appropriate authority.

Ms. de Beer agreed with Mr. Morris. She also noted that she was having difficulty with a different responsibility for professional accountants in business and professional accountants in public practice providing professional services to a non-audit client. Ms. Bastolla noted that internal auditors are professional accountants in business, and an internal auditor would think that reporting such a matter to the external auditor would be “passing the buck.”

Mr. Kottvedgaard noted that he was having difficulty envisaging a situation where a professional accountant would not be able to obtain information to confirm or dispel the suspicion. Mr. Diomeda noted that in an SME environment, a professional accountant in public practice providing a professional service to a non-audit client would likely have very easy access to those charged with governance.

Mr. James asked whether an auditor receiving information from another professional accountant who was providing other professional services to the client would conclude that this information was “received during the course of providing a professional service.” Mr. Franchini indicated that the Task Force would consider this matter.

Mr. Fleck thanked CAG members for their comments on the matter and noted that, while the CAG is not a consensus organization, it seemed to him as if:

- CAG members were supportive of the escalating approach;
- Many CAG members expressed concern about the proposed position for professional accountants in public practice providing a professional service to a non-audit client.

Requirement versus a right to disclose

Mr. Fleck asked CAG members for comments on the issue of a right to report or a requirement to report. He noted that even if CAG members were in favor of a right rather than a requirement, it would probably be appropriate to expose with a requirement, ask respondents a question, and if respondents felt that a requirement was too onerous, then to move to a right.

Mr. Morris re-iterated his view that there should be a requirement. Mr. Pannier noted that including a requirement would be a challenging standard but it was the appropriate standard to require reporting if, after escalation, the matter had not been appropriately addressed. Mr. Casel agreed that it would be appropriate to expose with a requirement, noting that this is consistent with the IESBA's objective of working in the public interest, but that there are practical difficulties in application of such a standard in some jurisdictions. Mr. Hansen noted that after having listened to all of the arguments he was now in favor of a requirement to report.

Mr. Gamble expressed the view that it should be a right rather than a requirement noting that it was not appropriate to impose western morality on other cultures, and a requirement may be particularly problematic in some jurisdictions. Ms. Sucher noted that while she was sensitive to what this might entail in some jurisdictions, a requirement to report was the appropriate standard. She noted that in the UK, auditors have an obligation to report certain matters to banking supervisors, but even with all the structures and protections that are in place, there are limited examples of auditors reporting matters.

Ms. Blomme noted that the FEE Ethics Working Party had not had a detailed discussion on this matter but generally she would support a right rather than a requirement. She noted that the primary responsibility should be on the company to report.

Mr. Waldron asked whether the arguments in favor of and against a requirement would be contained in the exposure draft. Mr. Franchini indicated that was a good suggestion and would provide support to the planned question of whether respondents agreed with the requirement to report.

Threshold for Reporting

Mr. Fleck asked CAG members for their views on the proposed approach of judging whether reporting is in the public interest by reference to what a "reasonable and informed third party, weighing all the specific facts and circumstances, would be likely to conclude about whether the public interest is best served by disclosing the matter to an appropriate authority

Mr. Grund indicated that he was struggling with the approach. He noted that the section was dealing with a *suspected* illegal act but the test is to consider what a reasonable and informed third party *weighing all the specific facts and circumstances*, would be likely to conclude about whether the public interest is best served by reporting to an appropriate authority. He noted that this gave him the impression that an investigation was necessary, which seemed inconsistent with the fact that the illegal act was a suspected illegal act. Mr. Fleck noted that the intention was to try and inject into the decision making the

concept of what a reasonable person would conclude should be reported. Mr. Franchini noted that the intent was to try and establish a threshold so there would not be a requirement for a professional accountant to report a frivolous matter. Mr. Franchini noted that the Task Force had previously proposed that the section would contain the following factors that the professional accountant would consider in determining whether reporting the matter to an appropriate authority would be in the public interest:

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

Mr. Franchini noted that when the IESBA and the CAG had considered these factors, the concern was that they would be too limiting – for example, the first factor, significance to financial reporting, would seem to indicate that if two entities (one large and one small) engaged in the same level of money laundering, the matter would have to be disclosed outside of the smaller entity because of the significance to financial reporting but disclosure would not be necessary for the larger entity. This did not seem right because what was important was the significance vis a vis the public interest. With respect to the third criteria of likelihood of recurrence, this could be interpreted as meaning that no disclosure was necessary if there was an assurance from management that there would be no repetition of the illegal act.

Mr. Kuramochi noted that the determination of whether reporting a matter was in the public interest may vary from jurisdiction to jurisdiction. Some jurisdictions may be more conservative such that a reasonable observer would expect more to be disclosed. Mr. Franchini noted that this seemed to provide the appropriate context and it should be jurisdictionally contextual. Mr. Kuramochi noted that this might prove challenging in a group audit situation if the parent company was in one jurisdiction and a subsidiary in another jurisdiction, and the two jurisdictions have a different view on whether reporting would be in the public interest.

Mr. Kuramochi noted that it was important that any guidance in the Code not conflict with the guidance in ISA 250. He noted that ISA 250 did not use a third party test.

Mr. Bradbury noted that some professional accountants deal with technical matters and, therefore, a reasonable and informed third party might not have the technical knowledge to make the judgment. Mr. Fleck noted that the reasonable and informed third party test was the threshold for reporting to an appropriate authority if the entity has not appropriately addressed the matter.

Ms. Sucher expressed support for the reasonable and informed third party test, noting that it was preferable to the three criteria considered previously.

Mr. Pannier noted that paragraph 225.13 seemed to establish a requirement for the professional accountant to consult, which seemed excessive.

Mr. Fleck asked CAG members whether they had any additional points they wished to raise, including any items noted on the feedback statement.

Mr. Koktvedgaard complemented the Task Force on the feedback statement noting that he thought it was a very important document.

Mr. Kuramochi noted that the two bullet points in paragraph 225.11 should be linked with “or” rather than “and.”

Mr. Kuramochi asked how a “reasonable period of time” would be interpreted. Mr. Fleck noted that it would be judgmental and depend upon the circumstances.

D. Conflicts of Interest

Mr. Niehues, Task Force chair, introduced the topic. He noted that since the CAG had discussed this project at its March 2011 meeting, the project had been discussed by the IESBA-National Standard Setters in April 2011, and the IESBA discussed proposed revisions to the sections at its June 2011 meeting. The Task Force has met three times since the June IESBA meeting, once by conference call, and will meet again to address comments from CAG members before presenting the proposals for approval as an exposure draft at the October 2011 IESBA meeting.

Mr. Niehues provided an overview of the proposed revisions to Sections 210 and 310 and Sections 320 and 340. He noted that while he welcomed comments from CAG members on any aspects of the proposals, there were three specific topics on which he was requesting the views of CAG members.

Description of a Conflict of Interest

Mr. Niehues noted that at its June 2011 meeting, the IESBA considered the following general description of a conflict of interest:

“A professional accountant may be faced with a conflict of interest when undertaking a professional activity. A conflict of interest creates a threat to objectivity and may create threats to other fundamental principles. Such threats may be created by:

- *Conflicts between the interests of two or more parties for whom the professional accountant undertakes professional activities; or*
- *Conflicts between the interests of the professional accountant and the interests of a party for whom the professional accountant undertakes a professional activity.”*

The Task Force received feedback at the IESBA meeting that the description should contain language stating that a conflict of interest may be such that a professional accountant is “unable to discharge his professional obligations effectively and in accordance with the fundamental principles in the Code.” The Task Force considered the

feedback and drafted an additional sentence to be included in the description of a conflict of interest after the bullet points in Sections 220 and 310:

“A professional accountant shall not allow a conflict of interest to compromise professional or business judgment.”

In the Task Force’s view this addition to the description is responsive to the recommendation. A professional accountant applies the guidance in Sections 220 and 310, as appropriate, to determine whether a conflict of interest is such that he is unable to discharge his professional obligations. This conclusion is stated in paragraph 220.8, which requires the accountant to decline to perform or discontinue professional services that could result in the conflict of interests when safeguards cannot address the threat. The Task Force is of the view that the first paragraph of the section should focus on the description of a conflict of interest and it would be premature to include the statement that some conflicts may be such that the accountant would be unable to discharge his professional obligations. Accordingly, the Task Force plans to present this addition to the IESBA at its October 2011 meeting.

Mr. Morris expressed the view that the additional sentence should be included in the description of a conflict of interest. Ms. Blomme agreed with Mr. Morris noting that while, in her opinion, the additional sentence was not really necessary, it did not hurt to include it. Ms. Sucher agreed noting that if the sentence provided additional context for people, it could do no harm to include it in the description.

Network Firms

Mr. Niehues reported that the guidance would propose that a professional accountant shall evaluate any potential conflicts of interest that the professional accountant has reason to believe may exist due to the interests and relationships of network firms. Some members of the Board have suggested that the “reason to believe threshold” is too low.

The Task Force considered stating that the professional accountant shall evaluate conflicts of interest when the professional accountant “knows or could reasonably be expected to know” that a conflict of interest may exist within a network of firms. The Task Force concluded that the “expected to know” threshold could create a need for new systems to enable network firms to know about relationships that other network firms have that create a conflict of interest. Whether such information can be shared across networks without violating local laws, regulations, or professional standards in various jurisdictions is unclear. Mr. Niehues noted that, for example, in his jurisdiction if the firm was providing forensic services to a client, that information could only be shared with other members of the firm on a strictly “need to know basis.”

The “reason to believe” test by contrast requires consideration of the facts available to the professional accountant at that time without the added complexity of potentially having to develop new systems and without the operational limitations due to possible legal and regulatory implications governing the sharing of such information across networks. It is

also consistent with paragraph 291.3 of the Code, which addresses identifying and evaluating threats to independence for network firms while performing assurance engagements other than audits and reviews.

The Task Force will propose the reason to believe test and also include examples of factors that the professional accountant should consider when evaluating whether a conflict of interest exists between firms in a network. The following language is to be recommended for inclusion in the bullet points of paragraph 220.5, which addresses identification and evaluation of conflicts of interest:

Evaluate any potential conflicts of interest that the professional accountant has reason to believe may exist due to interests and relationships of a network firm, taking into account factors such as the structure of the network, the geographic location of its firms and the nature of the clients served.

Mr. Koktvedgaard observed that with respect to the example of a firm performing forensic services for a client, if the firm was also providing taxation services to the same client, this would seem to be a conflict of interest. Mr. Niehues responded that he had provided that example to be illustrative of the information flows within a firm. In one of the Big 4 networks, there is a central conflict of interest checking function. This central function would have the information to enable the accountant to perform the conflict check and conclude whether a new engagement should be accepted. If the new engagement should not be accepted, the relevant network firm would be informed that the engagement could not be accepted. The communication would not explain why, it would simply inform the network firm not to accept the new engagement. The Task Force recognized that the large networks could establish such systems but felt that it was disproportionate to require small networks to establish such mechanisms. The Task Force was, therefore proposing a “reason to believe” test and provide factors that would be considered.

Ms. Sucher noted that she had mixed views about the proposed approach. On one hand she agreed that it was important that standards do not create the need for an unnecessary level of bureaucracy. This, however, needed to be balanced against any view that the driving factor was a desire not to place any additional burden on the small networks. Mr. Niehues responded that the Task Force is trying to strike the appropriate balance by requiring the firm to consider any conflicts that it had reason to believe may exist. This is the same test as used for independence for assurance engagements that are not audit or review engagements. In the independence example, the information flow is with the same client. The conflict of interest example is more complex because it will involve different clients. Mr. Fleck noted that the issue was compounded because many of the smaller networks might not have the right to share information across jurisdictional borders.

Mr. Gamble noted that after listening to the arguments and the Task Force rationale, he felt that proposed approach and draft wording struck the right balance.

Confidentiality

Mr. Niehues reported that the IESBA has agreed to include guidance in Section 220 that addresses situations where, in the course of performing a professional service, a professional accountant in public practice may receive confidential information from a client that would be helpful to use directly in providing the service but could potentially damage that client's interests if disclosed to another client of the firm. The guidance recognizes that, although it would generally be necessary in such situations to seek the consent of the client to use the information, there are situations when this might not be practicable, but where nevertheless it is in the public interest for the professional accountant's firm to be able to accept or continue with the engagement.

The Task Force considered including an example of such a situation within the proposed Section 220 in order to add clarity to the guidance. The example is as follows:

A firm might have two clients, one of which (the offeror) proposes to launch a takeover bid for the other (the offeree) where local regulation requires the offeror to obtain from the firm certain accounting reports with respect to the takeover bid. If the firm holds confidential information in respect of the offeree that could be relevant to the engagement for the offeror, consent of the offeree would normally be required as to the arrangements to maintain the confidentiality of the information, but the firm might be precluded from seeking such consent because the offeror's intentions cannot be disclosed to the offeree. In some cases, however, it may be impossible (for example due to time constraints) for another firm to undertake the engagement for the offeror, thus preventing the offeror from proceeding with its takeover plan.

The Task Force agreed that the example may be too detailed and specific for inclusion in the Code. Thus, the Task Force will propose that the example be included in the explanatory memorandum when presenting the matter at the IESBA's October 2011 meeting.

Ms. Blomme expressed the view that, for the practical reasons noted in the agenda paper, the example was useful. She felt that because the example brings the previous paragraph to light, it would be preferable to include it in the Code as opposed to only in the explanatory memorandum. The exposure draft contains the explanatory memorandum but it is not used by accountants when the final standard is issued.

Sections 320 and 340

Mr. Niehues reported that professional accountants in business may encounter certain ethical conflicts, such as undue pressure and self interest threats, when preparing financial information if an arrangement exists whereby compensation is linked to the results of financial reporting. The IESBA agreed that these conflicts are not part of the scope of the conflicts of interest project and noted that they are addressed in Sections 320, *Preparation and Reporting of Information*, and 340, *Financial Interests*, of the Code. However, because those sections address a form of conflict that can threaten compliance with the fundamental principles, the Task Force was asked to consider

whether the changes to Sections 220 and 310 have implications for Sections 320 and 340 and therefore certain refinements should be made to those sections, or whether the IESBA should seek to add a new project to its agenda to reconsider these sections.

There are different views on the Task Force as to whether a project should be sought to undertake a more extensive reconsideration and rewrite of the sections. The redrafts of the sections that are being considered by the Task Force illustrate the types of refinements being considered. For example, proposed paragraph 310.3 calls for the accountant to be alert to all interests and relationships that might give rise to a conflict of interest. A conforming change to Section 340 would include a similar directive, calling for the accountant to be alert to the principle of integrity and the obligation to be honest and straightforward in the face of, for example, pressure from a superior "to manipulate price sensitive information in order to gain financially" (see current paragraph 340.1).

Some members of the Task Force believe it is appropriate to make these changes within the scope of the conflicts of interest project, in particular to recognize similar threats to compliance with the fundamental principles that may be created by compensation and incentive schemes, such as threats to integrity, objectivity, and professional competence for professional accountants in business. Other Task Force members question whether these changes would be sufficient and whether the relevant sections of the Code need to be reconsidered, acknowledging that such a task is beyond the scope of the conflicts of interest project.

The Task Force agrees, however, that whereas it may be desirable to take the opportunity to make amendments to Sections 320 and 340 at this time, the primary concern is to proceed to finalize the proposals for Sections 220 and 310 of the Code, which fall within the core remit of the conflicts of interest project. Mr. Niehues indicated that he would welcome the views of CAG members on the appropriate way forward.

Mr. Fleck asked CAG members whether there was a broad consensus that the original part of the project (Sections 220 and 310) should be exposed for public comment when they were ready and should not be unduly held up by revisions to other sections. CAG members agreed with this view.

Ms. Blomme asked why the Board could not expose a "middle ground," which would include the proposed changes to Sections 220 and 310 and at the same time the proposed refinements to Sections 320 and 340. The exposure draft could also contain a question asking respondents whether additional changes were needed to Sections 320 and 340.

Mr. Morris stated that it was difficult to answer the question whether a "significant re-write" was needed for Sections 320 and 340, without having a clear understanding of what the re-write would address. He expressed the view that what was included in the agenda papers seemed to be a sensible approach and a step forward and encouraged the Board to expose the document.

Mr. Fleck asked CAG members whether there were any matters, including those addressed in the feedback statement, they wished to discuss. No points were raised.

Mr. Niehues thanked CAG members for their input. He indicated that the comments from CAG members would be very useful to the Task Force and would be considered at its meeting the following week.

E. Breach of an Independence Provision

Mr. Dakdduk introduced the topic, providing an overview of the proposed approach of the project. The proposed guidance would require a firm to take the following actions if a breach is identified:

- Take steps as soon as possible to suspend or eliminate the breach;
- Consider whether there are any applicable legal or regulatory requirements in relation to how a breach is to be addressed and, if so, take the steps necessary to comply with those requirements;
- Evaluate the significance of the breach and its impact on the firm's objectivity and ability to issue the audit report;
- Determine whether action can be taken to satisfactorily address the consequences of the breach. In making this determination the firm shall consider whether a reasonable and informed third party weighing the significance of the breach would be likely to conclude that objectivity would be compromised such that the firm is unable to issue an audit report;
- If the firm determines that action cannot be taken, after discussion with those charged with governance, take the steps necessary to terminate the audit engagement;
- If the firm determines action can be taken, discuss the breach with those charged with governance as soon as possible and if those charged with governance agree, ensure the actions are implemented; and
- Document the actions taken and all the matters discussed with those charged with governance and, if applicable relevant regulators.

Focus on Independence

Mr. Dakdduk noted that the Task Force reviewed all the provisions of the Code and concluded that a distinguishing feature of the independence provisions is the consequences of the breach – if an independence requirement is breached and the firm cannot issue an opinion, there is a potential for harm to, for example, third parties who are planning certain activities upon receiving the audited financial statements and may be working within tight time constraints. Switching auditors unexpectedly could, depending upon the timing, result in the company having difficulty meeting its filing requirements, missing a market opportunity, and delaying a planned transaction. The Task Force, therefore, recommended to the IESBA, and the IESBA agreed, that the provisions should apply only to the independence requirements of the Code. If the impact of the breach on the firm's objectivity was trivial or inconsequential, the consequences of a firm resignation would be disproportionate to the breach. In the case of other provisions in the Code, there is not the same opportunity to avoid unnecessary harm to the public if there is a breach of a requirement.

Mr. Hansen noted that it seemed appropriate to focus on a breach of an independence requirement because of the implications of such a breach. He asked whether the guidance would address a breach that had occurred in a prior period. Mr. Dakdduk noted that paragraph 290.49 addressed an identified breach that occurred prior to the issuance of the previous audit report. Mr. Hansen asked how much time would have to pass before an auditor could resume the audit. For example, if a material valuation service was provided in a period and the firm resigned, how much time would have to pass before the firm could resume the audit? Mr. Dakdduk noted that it would be a judgment call that would depend upon the facts and circumstances.

Mr. Koktvedgaard noted that breaches of other requirements in the Code might occur and it would, therefore, be useful to have some general guidance on how such a breach might be rectified.

Ms. Sucher agreed that the focus should be on independence but it might be useful to consider whether the Code should also contain a general statement that outlines the thought process an accountant would undertake if a breach of another provision occurred.

Mr. Morris agreed that a breach of an independence requirement should be addressed in the Code but was not convinced that there should be a general statement to address all other breaches. He expressed the view that the IESBA should consider the consequences of other possible breaches of the Code. Having gained this understanding, the IESBA might conclude that there are several other categories of breaches each one of which would require a different approach.

Mr. James agreed that the focus on independence was correct but it would be useful for the IESBA to give close attention to the public interest implications of a breach of other requirements within the Code.

Mr. Kuramochi questioned the relationship between the breaches provisions and paragraph 200.10. Mr. Dakdduk responded that paragraph 200.10 explained that a professional accountant needs to exercise judgment to determine how best to deal with threats that are not at an acceptable level. The breaches provisions are not intended to undermine the professional judgment implicit in the framework, rather they are intended to provide a rigorous framework for the professional accountant to apply when a breach of an independence requirement has been identified.

Mr. Cassel expressed the view that it would be useful to add some general guidance in Section 100 explaining the process a professional accountant would go through if a breach not related to independence was identified. Mr. Hansen indicated that he could support such an approach.

Mr. Pannier agreed that the primary focus should be on a breach of an independence requirement but it would be useful to consider whether there should be a separate general piece to address other breaches.

Mr. Grund noted that the proposed guidance seemed to send a message that there were some independence breaches that would not result in resignation and some other breaches that would result in resignation. He asked how the IESBA could be satisfied that the dividing line between the two types of breaches was correct. Mr. Dakdduk responded that this was based on the assessment of the significance of the breach. He noted that the two extremes could easily be identified, what was more difficult were breaches that were not at either extreme. This was why the IESBA was of the view that there should be detailed guidance on how to evaluate the significance of a breach and a robust framework to guide that evaluation.

Mr. Grund stated that he was concerned with consistency of application, noting that some audit committees may be more accepting of a breach than other audit committees. Mr. Dakdduk noted that without a detailed framework there would be more inconsistency in the treatment of a breach.

Ms. Sucher noted that she understood the process that the IESBA was trying to establish but felt that some of the language could be tidied up – in particular paragraphs 290.48 and 49 seemed to be reversed and the language could be improved.

Mr. Grund expressed his concern that the guidance seemed to condone a breach of an independence requirement. Mr. Fleck noted that CAG members had expressed the view that resignation in the case of any breach of an independence requirement was not appropriate and, therefore, the Code should contain provisions on how a breach was to be addressed. Mr. Grund noted that there would always be a concern with resignation and even the entity would be reluctant for the auditor to resign if there was a breach to an independence requirement. Mr. Fleck noted that there was an additional discipline in the documentation requirement. The strength of the documentation requirement was that the matter could be reviewed after the fact and an assessment could be made as to whether the action that had been taken was appropriate in the circumstances.

Mr. James asked whether an alternative approach would be to specifically scope out the instances that would not create a violation – for example, the Code could state that holding a single share would not be a violation. Mr. Fleck noted that was similar to the existing approach, which indicates that independence will generally be deemed not to compromise independence provided certain actions are taken. He also noted that the significance of a breach would depend upon the scale, the role of the individual within the firm, and the perception of the consequences of the breach.

Mr. Kuramochi noted that the drafting of paragraph 290.48 seemed to imply that those charged with governance could override the auditor's decision to terminate the engagement. Mr. Fleck agreed that the drafting could be improved. He noted that even with improvements to the drafting of paragraphs 290.48 and 290.49, Mr. Grund's concerns would not be addressed. Mr. Kuramochi noted that it would be very important to get input from audit committees. Ms. Munro noted that the Task Force would be

developing an approach to reach out directly to audit committees to solicit their input on the proposals.

Ms. de Beer expressed her view that the balance in the proposed approach seemed to be appropriate. There are instances where a breach should result in resignation and instances where resignation would be disproportionate.

Mr. Cassel expressed the view that he was in favor of guidance to help auditors address a breach. He noted that it should be clear that independence was necessary and compliance with the requirements was important. However, independence is not binary, it is not an on/off switch.

Timing of Communication

Mr. Dakdduk indicated that the IESBA had considered the timing of reporting a breach to those charged with governance. The IESBA had considered two broad approaches:

- As soon as possible – the firm has evaluated the breach and determined whether actions can be taken to address the breach. Such an approach enables those charged with governance to fulfill their responsibility with respect to the independence of the audit and to have a role in determining whether action can be taken to address the consequences of the breach;
- On a timely basis – which would be based on significance. Such an approach would promote quicker reporting of more significant breaches, for example, a network firm providing a significant prohibited non-assurance service would be reported more quickly than a breach created by the spouse of a partner holding some shares in an audit client of the office.

Mr. James noted that he would have been comfortable if the requirement to report was “immediately” but he understood the arguments for “as soon as possible” because some time would be needed to evaluate the significance of the breach. He noted that “as soon as possible” did, however, seem to imply some flexibility on timing and the IOSCO subcommittee would be more comfortable if the reporting was “without delay.” Mr. Fleck noted that the two concepts could be combined to read “as soon as possible, without delay.”

Mr. Hansen noted that when the SEC Sarbanes-Oxley provisions were issued there were questions as to how the provisions were to be implemented. Much of the discussion had been between the firm and the chair of the audit committee as opposed to all of the audit committee. He questioned whether a similar approach could be taken such that there is an almost immediate communication to the audit committee chair.

Mr. James expressed the view that there should be a requirement to report a breach to a regulator. He noted that some IOSCO members are of the view that if a regulator is silent as to whether breaches should be reported to them, the firm should be required by the Code to report a breach. Mr. Fleck noted that regulators have the power to require breaches to be reported to them, and if the Code contained such a requirement, the

IESBA would, in effect, be establishing regulation in those jurisdictions where regulators were silent and had chosen not to require reporting.

Other Matters

Ms. Sucher noted that paragraph 290.40 indicated that the firm should take steps as soon as possible to *suspend* or eliminate the interest or relationship that caused the breach. She indicated that “suspend” sounded as if the matter would be stopped for a period of time but could then be resumed.

Mr. Koktvedgaard noted that the guidance seemed to be directed to listed entities and noted that in small entities there may not be a body charged with governance.

Mr. James noted that the language in paragraph 290.41 “take steps” was not as definitive as it could be and it would be preferable to use language such as “shall comply with.”

Mr. Hansen asked what would be the effective date of the proposals. Ms. Munro responded that while the effective date had not been discussed by the IESBA, the Task Force was of the view that a relatively short effective date would be appropriate. The proposals do not call for any changes in systems, what is required is increased transparency through reporting to those charged with governance and through documentation.

Mr. Fleck asked whether CAG members had any final comments including whether there were any comments on the feedback statement.

Mr. James noted that the feedback response to Mr. Kuramochi’s view that it was important to consider the aggregate effect of any violations was that this was implicit in the approach. He noted that he did not think this adequately addressed the point that had been raised.

F. SMP/SME Working Group

Mr. Dakdduk introduced the topic, providing an overview of the initiative. He noted that the IESBA SME/SMP Working Group was formed in late 2010 to identify and advise the Board on unique and challenging issues faced by professional accountants in SMEs and SMPs when complying with the Code. The remit of the Working Group does not include independence provisions for public interest entities.

Mr. Dakdduk noted that SMEs are an important contributor to the world’s economies. SMEs account for the majority of private sector employment and are also a major source of economic growth, innovation, and job creation in most if not all countries around the globe. Many SMEs are dominated by an owner-manager, lack a robust control environment, and are subject to resource constraints (time, funds, qualified individuals, etc). SMEs and professional accountants in SMEs often value the advice that their professional accountants are able to provide them – it is important to keep this in mind while addressing independence requirements.

Mr. Dakdduk reported that the IESBA had received an interim report from the working group at the June 2011 meeting and would receive the final report at its October 2011 meeting. He then provided an overview of the interim recommendations of the Working Group.

Knowledge and Understanding of the Code

Resource constraints, including lack of time, funds, and qualified individuals available to provide direction and advice, often inhibit the ability of professional accountants in SMEs and SMPs to develop their knowledge and understanding of the Code. This challenge may be exacerbated by the length of the Code, particularly when the professional accountant's language is other than English and translation is required.

The Working Group's preliminary recommendation is to develop guidance for users to facilitate general learning and application of the Code to specific circumstances. This guidance can consist of *IESBA Staff Questions and Answers*, supplemented as appropriate by case studies. It would also be useful for the IESBA to develop a synopsis of the Code, publish the Code in a format that facilitates ready access to the sections of the Code relevant to the particular user, and liaise with member bodies to identify how this guidance and other tools that the IESBA may develop may be aligned with training programs to facilitate learning about the Code.

Safeguards

The Code states that the risk of inadvertently making any significant judgments or decisions on behalf of management can be reduced when the firm gives the client the opportunity to make judgments and decisions based on an objective and transparent analysis and presentation of the issues. Such "informed management" is considered by many to be an effective safeguard, yet it is not listed in any other provisions of the Code as an appropriate safeguard. SMEs typically rely upon their professional accountant to provide advice on a variety of matters in addition to performing an audit or review. This advice enables them to overcome resource constraints and is often valued more than the audit or review. The Working Group's preliminary recommendation is to clarify the importance of informed management. Paragraph 200.14 would need to be taken into account, which provides that it is not possible to rely solely on such safeguards to reduce threats to an acceptable level.

Safeguards

The Code provides many examples of safeguards available to professional accountants when managing threats. However, many of these safeguards are not readily available to sole practitioners or SMPs with only one audit/review partner. The preliminary recommendation of the Working Group is that the IESBA should develop guidance for sole practitioners and SMPs with only one audit/review partner to facilitate the identification of appropriate safeguards.

Network Firms

Many SMPs develop relationships with correspondents either in their own jurisdiction or abroad. Many sole practitioners join together to share office space and administrative

staff, and perform reciprocal internal quality reviews. In some circumstances, these relationships may constitute an “alliance” but not a network. There is concern regarding the application of the definition of a “network” as defined in the Code, and the related independence requirements. The preliminary recommendation of the Working Group is that the IESBA develop guidance on the Code’s definition of a network firm.

Other Projects for IESBA

Much of the Code is focused on the independence of the professional accountant providing (or in a firm providing) audit, review, or other assurance services. Many professional accountants in SMPs provide non-assurance services. The Code provides conceptual guidance related to non-assurance services. The preliminary recommendation of the Working Group is that future IESBA workplans consider expanding the Code to provide more specific guidance on non-assurance services, particularly tax services.

Ongoing Consideration of SME/SMP Issues

SME/SMP issues warrant continuing attention and the preliminary recommendation of the Working Group includes establishing a process to ensure consideration of SME/SMP issues and consideration of the establishment of an SME/SMP advisory group.

Mr. Dakdduk invited Mr. Attolini, deputy chair of the IFAC SMP Committee and member of the IESBA SME/SMP Working Group to comment.

Mr. Attolini noted that it was important to understand that professional accountants in SMPs and SMEs did not desire a separate standard. It was important that SMPs and SMEs comply with the same standards as larger entities because SMPs and SMEs grow and a different standard for smaller entities would inhibit such growth. He noted that, when developing standards, it was very important to “think small first” because, having developed a standard for large entities, it was very difficult to scale back a standard to make it suitable for small entities. He emphasized the importance of SMEs and their impact on the economy. He noted that while an individual SME may not be of significant public interest, the overall impact of SMEs on the worldwide economy is of significant public interest. He noted that the Working Group had many recommendations and his personal view was that it may be challenging for the IESBA to respond to all of the recommendations. It would, therefore, be important to prioritize the projects that should be undertaken.

Mr. Diomeda noted that the SME/SMP Working Group had developed preliminary recommendations with respect to the provision of taxation services. He stressed that in addressing this recommendation it was important to also consider corporate governance – for example, the SME needs to respect the Civil Code and the owner/manager needs to act in an ethical manner.

Mr. Koktvedgaard commented that the discussion had made him wonder whether, in today’s complex business environment, it was appropriate to have firms that were sole practitioners.

G. PIOB Remarks

Mr. Fleck invited Mr. Bhave, representing the Public Interest Oversight Board (PIOB), to make some comments. Mr. Bhave noted that he was pleased to have observed the IESBA CAG meeting. He noted that at previous meetings there had been some questions about the role of the PIOB and he encouraged CAG members to look at the PIOB website. On the website readers can find annual reports of the PIOB and decision summaries for each PIOB meeting.

Mr. Bhave thanked CAG members for their contribution and noted that the topics that had been discussed were of critical importance and were of significant public interest. He indicated that he was pleased with the direction of the discussion. He noted that there may be requirements that went beyond the legal authority in some jurisdictions but this was appropriate because it would earn IFAC the moral authority to address such issue.

He noted that some of the IESBA projects would be subject to the extended review of the PIOB.

Mr. Fleck thanked Mr. Bhave for his remarks.

H. Close of Meeting

Mr. Fleck noted that this meeting would be the last meeting for Mr. Cassel. He thanked Mr. Cassel for his contribution to the CAG and thanked all members for their attendance and closed the meeting.

Future Meetings:

- March , 2011 (Europe TBD)