

June 18-20, 2012 - New York, USA

**Draft Minutes of the Meeting of the
International Ethics Standards Board for Accountants
February 20-22, 2012
Dublin, Ireland**

Members*Present:*

Ken Dakduk

Helene Agelii

Robert Franchini

James Gaa

Caroline Gardner

Gary Hannaford

Jörgen Holmquist

Peter Hughes

Felicitas Irungu (in part day 1, day 2 and 3)

Chishala Kateka

Wui San Kwok

Stefano Marchese

Alice McCleary

Marisa Orbea

Isabelle Sapet

Kate Spargo

Don Thomson

Brian Walsh

Technical Advisors

Lisa Snyder

Tone Maren Sakshaug

Sylvie Soulier

Tony Bromell

Patrick Wanjelani

Andrew Pinkney

Elbano de Nuccio

Eva Tsahuridu

Liesbet Haustermans

Jean-Luc Doyle (day 1 and part day 2)

Kim Gibson

Non-Voting Observers*Present:*

Richard Fleck

Koichi Uzuka

Regrets:

Juan Maria Arteagoitia

Observing on behalf of PIOB

Eddy Wymeersch

Susana Novoa

IESBA Technical Staff*Present:*

Jan Munro

Chris Jackson

Guests

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Present: Diana Hillier (Item 6)
Giancarlo Attolini (Item 7)
Martijn van Opijnen (Item 8)

1. Introduction and Administrative Matters

Mr. Dakdduk opened the meeting noting that apologies had been received from Ms. Irungu, who would be arriving after lunch on day one and from Mr. Arteagoitia.

Mr. Dakdduk welcomed four new members to the Board: Helene Agelii, Gary Hannaford, Chishala Kateka, and Stefano Marchese.

He invited all those at the table to introduce themselves briefly, and noted the diversity of experience and geography on the Board. He said that there would be three observers who will attend for specific items: Mr. Attolini, chair of the SMP Committee, Ms. Hillier chair of the International Auditing and Assurance Standards Board (IAASB) ISA610 Task Force, and Mr. van Opijnen of the AFM (Netherlands Authority for the Financial Markets) who will attend in place of Ms. van Diggelen.

Mr. Dakdduk thanked the IESBA's hosts: Chartered Accountants Ireland and the Institute of Certified Public Accountants in Ireland for hosting the meeting.

Minutes of the Previous Meeting

The minutes of the October 2011 meeting were approved, subject to some editorial revisions. Mr. Dakdduk provided an update on activities since the October 2011 meeting.

Public Company Accounting Oversight Board (PCAOB)

The PCAOB issued a Concept Release on Auditor Independence and Audit Firm Rotation. The main focus is to consider whether mandatory firm rotation is an appropriate way to enhance auditor independence, objectivity, and professional skepticism. A working group of the Board, chaired by Ms. Gardner, led the development of the Board's response letter. The letter did not express an opinion on firm rotation as the Board reaches positions only after full due process and deliberations and firm rotation has not been the subject of the IESBA's due process and deliberations. The PCAOB will hold a public meeting in March.

Planning Committee

The Board's Planning Committee met in London and by conference call. The subjects discussed are reflected in the agenda materials for this meeting. One matter was how to be more responsive to the needs and expectations of the Board's constituents given developments in Europe and the US. This is included in agenda item 4 and will be discussed in terms of a revised strategy for 2012. The Planning Committee also considered the report from the IESBA SME/SMP Working Group, which is Item 7, and how to respond quicker to the need for interpretive guidance on the Code and other matters. The staff will discuss a proposal to issue Staff Ethics Alerts as a way of satisfying this need. The process for developing such a document is included in agenda item 5.

Consultative Advisory Group (CAG)

Mr. Dakdduk stated that the CAG meets twice each year. The next meeting of the CAG is scheduled for March 5, 2012 in Brussels. He encouraged Board members to attend the meeting.

International Organization of Securities Commissions (IOSCO)

Mr. Dakdduk reported that he and Ms. Munro met with members of IOSCO's Standing Committee No. 1 (SC 1) in November to discuss the breaches project and the illegal acts project. They will be meeting with a subcommittee of SC 1 in March to discuss progress on these projects. He

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noted that these meetings are valuable because they enable us to obtain feedback as our projects progress.

Outreach

Mr. Dakdduk reported that since the last IESBA meeting, Board members made presentations at the following:

- National Association of State Boards of Accountancy Annual Meeting – Mr. Dakdduk
- Dubai Financial Services Authority Regional Conference – Mr. Walsh

Other matters

The IFAC project to revise the definition of professional accountants had received diverse comments from various boards and committees within IFAC. Because of priorities and because the current definition did not present a particular problem for most boards and committees, the IFAC Board decided to defer the project.

Mr. Dakdduk reminded the Board that member bodies must comply with the seven Statements of Membership Obligations (SMO). The revised SMOs had been exposed for comment with a response date of March 5. They are being revised to be more consistent. The portions of the SMOs that relate to the IESBA are in the preface and SMO4. He encouraged Board members to report to him or Ms. Munro any relevant matters they identify.

Ms. McCleary led an IESBA working group charged with developing the Board's input to IFAC on its proposed definition of the term "public interest." The IFAC Board revised the strategic direction of this effort to focus on examining the approach needed to set standards in the public interest, as opposed to defining the term. There will be more on this to report in the future.

A fourth IESBA meeting has been scheduled for 2012. The next meetings will be June 18-20, October 15-17, and December 10-12 in New York. The June and October meetings will be held at the IFAC offices and the December meeting will be at the AICPA. The policy is to hold three out of four meetings each year in New York.

A Board member asked Mr. Dakdduk whether there is a policy that addresses IESBA members signing response letters to the IESBA on behalf of their employer or nominating body. Mr. Dakdduk stated that he is not aware of a policy. He noted, however, that signing such letters could raise a question about the independence of the IESBA member and could make it difficult for the member to be, and to be seen as, objective during the Board's deliberations. He offered as an example a situation in which the Board's discussions on a project go in a direction that is different than the positions in the response letter that the Board member is associated with. He recommended that Board members consider this when deciding whether to be involved in developing a response letter.

2. Breach of a Requirement of the Code

Ms. Spargo introduced the project.

In October 2011, the IESBA exposed for comment proposed changes to the Code's provisions addressing a breach of a requirement of the Code. The comment period ended in January 2012 and 43 responses had been received as of February 9, 2012.

The Task Force reviewed all comments received and identified some key issues on which it would like the direction of the IESBA. Ms. Spargo noted that the Task Force had focused on comments on the first five questions raised in the exposure draft. The Task Force will consider comments on the remaining three questions (impact analysis, proposed effective date, and approach in Section 291) in detail in a future Task Force meeting.

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Ms. Spargo noted that the exposure draft would require a firm that identifies a breach of an independence requirement to determine whether termination of the audit engagement is necessary or whether action can be taken to satisfactorily address the consequences of a breach such that the firm can still issue an audit opinion. Generally, the firm would be required to:

- Terminate, suspend, or eliminate the interest or relationship that caused the breach;
- Comply with any applicable legal or regulatory requirements with respect to the breach;
- Evaluate the significance of the breach and its impact on the firm's objectivity and determine whether action can be taken to satisfactorily address the consequences of the breach;
- Communicate with those charged with governance and, if the firm determines that action can be taken to satisfactorily address the consequences of the breach, obtain their agreement with the proposed course of action; and
- Document the action taken and all the matters discussed with those charged with governance and, if applicable, any relevant regulators.

Inclusion of breaches provisions in the Code

Ms. Spargo reported that the majority of respondents agreed that the Code should contain provisions that address a breach of a requirement; three respondents did not support this. The IESBA confirmed that the Code should contain such provisions...

Mr. Wymeersch referred to paragraph 100.10, which applies to all violations. He noted that the paragraph did not provide a great deal of guidance for such breaches compared to the detailed guidance given in Section 290. He suggested that paragraph 100.10 could provide more guidance for accountants who breach provisions in the Code other than those that deal with independence. He also believed that if a breach was serious, there might be a need to report it to a regulator. The IESBA agreed that the Task Force should consider expanding paragraph 100.10 to provide more guidance. This could possibly be achieved by splitting it into two and providing more of the thought process an accountant could follow.

Communicating all breaches, timing, threshold and reporting to regulators

Ms. Spargo summarized the responses to question three of the exposure draft: *Do respondents agree that a firm should be required to communicate all breaches of an independence requirement to those charged with governance? If not, why not, and what should be the threshold for reporting?*

- Responses were mixed with 24 respondents agreeing with the proposal that all breaches should be communicated to those charged with governance.
- Seven respondents expressed the view that while all breaches should be communicated to those charged with governance, the significance of the breach should affect the timing of the communication.
- Six respondents expressed the view that those charged with governance should be permitted to establish a threshold below which insignificant breaches would not be communicated.
- 13 respondents expressed the view that breaches that were not significant need not be communicated to those charged with governance.
- Three respondents commented on reporting a breach to a regulator.

In considering the diversity of responses, and the number of comments on whether all breaches should be reported and the timing of reporting, Ms. Spargo noted that the Task Force is considering whether it would be appropriate to permit the timing of the reporting of less significant breaches to be established by those charged with governance. The Task Force believes that such an approach might strike an appropriate balance between the views of those who believe that less significant breaches should not be reported and those who prefer that all breaches be reported.

The IESBA discussed the respondents' comments and whether it was appropriate to provide

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some flexibility on the timing of reporting and the following points were noted:

- Communication of all breaches would be important to maintain transparency;
- If the auditor has the flexibility to determine which breaches do not need to be reported, this would introduce an element of subjectivity that could lead to inconsistent outcomes;
- Permitting breaches to be communicated in accordance a protocol agreed with those charged with governance might address the concerns of those who feel that there would be too much subjectivity;
- The exposure draft proposed that all breaches be treated in the same manner. Given that breaches vary in severity, it might be appropriate for the timing of communication to vary as well;
- Requiring the same timing of communication for all breaches could, inappropriately, convey that all breaches are of the same significance;
- The auditor who determines that actions can be taken to address the consequences of the breach should be required to obtain the concurrence of those charged with governance because those charged with governance have a responsibility to hire an independent auditor.

After discussion, the IESBA confirmed that all breaches should be communicated to those charged with governance but there should be flexibility on timing, possibly with a timing that would be agreed with those charged with governance.

There had been a lack of responses from those charged with governance or their representative bodies and further efforts should be made to obtain their views on whether they wish to hear about all breaches, irrespective of their significance, and the timing of the reporting. The Task Force agreed to undertake some specific outreach to obtain this input.

Ms. Spargo noted that a respondent had suggested that reporting to a regulator should be required in those jurisdictions where reporting is not required but is encouraged by the regulator. The IESBA noted that regulators have the authority to require a firm to report independence breaches. Therefore, if a regulator wished to require this, it should be left to the regulator to require it.

Third party test

All but four respondents to the exposure draft agreed that the reasonable and informed third party test is appropriate in determining whether an action satisfactorily addresses the consequence of a breach of an independence requirement. One respondent (IOSCO) noted that the test should be based on the views of a reasonable and informed investor and not the auditor. The IESBA noted that the reasonable and informed third party test was not intended to refer to another auditor and asked the Task Force to consider clarifying this.

Definition of those charged with governance

Ms. Spargo reported that one respondent noted that the definition of “those charged with governance” in the Code is not consistent with the definition in ISA 260 *Communication with Those Charged with Governance*. The Task Force considered the matter and agreed that the definition is not consistent. The Task Force recognizes that a revision to the definition of those charged with governance was not originally contemplated as part of this project but it is willing to address the matter as a separate but companion work-stream.

The IESBA considered the matter. It was noted that the definition in the Code is:

The persons 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.

The definition in ISA 260 adds:

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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.

The IESBA asked the Task Force to consider the definition in ISA 260 and determine whether a conforming change should be made to the Code. If the Task Force believes that such a change should be made, the Task Force will develop a separate exposure draft for that purpose.

Agreement of those charged with governance

Ms. Spargo noted that some respondents stated that they did not agree that the firm may continue with the audit engagement only if those charged with governance agree that action can be taken to satisfactorily address the consequences of the breach. The respondents expressed concern that this implied that the auditor was delegating responsibility for making that decision to those charged with governance. The IESBA discussed the matter and the following points were noted:

- The proposal is not intended to enable the auditor to abdicate its responsibility to make the requisite judgment about the impact of the breach on its objectivity and the adequacy of any safeguards.
- It is appropriate to engage those charged with governance when the auditor believes action can be taken to satisfactorily address the consequences of the breach.
- "Mutual understanding" or "concurrence" may be preferable descriptions to "agreement."
- It was not intended that the agreement involve a negotiation between the auditor and those charged with governance.

Matters that should be discussed

IESBA members were asked to consider the suggestions for paragraph 290.46 regarding the matters that should be discussed with those charged with governance. All but two respondents expressed general support for the matters that should be discussed. In reviewing the comments, the IESBA asked the Task Force to consider whether the communication should be in writing.

Next steps

It was noted that the CAG would discuss the project and provide input on March 5. The Task Force has scheduled two meetings, and a revised proposal and the detailed cut and paste of the respondents' comments will be provided to the IESBA in June. The CAG is expected to consider the revised proposal in September and the IESBA would approve it for exposure in October.

Mr. Dakdduk thanked the Task Force and, in particular, Ms. Spargo as chair, for the work they have done on this project to date.

3. Responding to a Suspected Illegal act

Mr. Franchini introduced the topic and provided an overview.

At its October 2011 meeting the IESBA discussed a proposed exposure draft. The exposure draft proposed that after escalating a suspected illegal act within the client or employing organization, a professional accountant would be required to disclose certain illegal acts to an appropriate authority. Disclosure would be required when the accountant determined that the suspected illegal act was of such consequence that disclosure would be in the public interest and the entity had not disclosed the matter.

The types of illegal acts that would require such disclosure are:

- Suspected illegal acts that directly or indirectly affect the client's financial reporting.
- Suspected illegal acts the subject matter of which falls within the expertise of the professional accountant.

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The IESBA discussed the proposal and requested the Task Force to prepare an exposure draft that was based on a right that the accountant is expected to exercise.

The Task Force met on December 5-6th and on January 25th to consider the IESBA comments and developed an approach that is based on a right that the accountant is expected to exercise. The Task Force also reviewed the requirement that was discussed with the IESBA in October with a view to seeing whether the concerns expressed could be addressed. The Task Force presented both approaches for the consideration of the IESBA.

The Task Force also discussed whether it had a preferred position and the majority view of the Task Force is that there should be a requirement for auditors and a right for others. A minority view is that there should be a requirement for all accountants.

Level of duty: Requirement or Right

Mr. Franchini asked the Board to consider the application of a “right” or a “requirement” to each of the four categories of professional accountants:

- Auditor
- Professional accountant providing professional services other than an audit to an audit client
- Professional accountant providing professional services to a non-audit client
- Professional accountant in business.

The Task Force recommended the first two categories be treated as one. A majority of the Task Force is of the view that the auditor and accountants providing non-audit services to an audit client should have a requirement to disclose. Accountants performing non-assurance services for non-audit clients and accountants in business should disclose to the external auditor. They also have a right to disclose to an appropriate authority and should be expected to exercise that right.

Mr. Franchini presented the Task Force’s rationale for a requirement to apply to auditors. Auditors act in the public interest. There is a greater expectation that an auditor would disclose suspected illegal acts than accountants providing non-audit services or accountants in business. The IESBA supported a requirement for auditors and professional accountants providing other professional services to an audit client, with an exception clause.

For the other two categories, the proposal prompts the professional accountant to report the suspected illegal act to the external auditor, if any. If there is no auditor, the matter should be documented and the professional accountant should decide whether to be associated with the client/employer.

One Board member was opposed to any external disclosure because confidentiality is a fundamental principle and that it is in the public interest for a client or employer to be able to rely on accountants to always comply with that principle. A contrast was drawn with lawyers or bankers; it was thought that they would maintain confidentiality in all cases.

The IESBA considered three options for paragraph 225.20 (which applies to professional accountants providing services to a non-audit client). It was noted that the same reasoning also applies to professional accountants in business. The three options were:

1. A right to disclose to an appropriate authority that the accountant is expected to exercise,
2. A requirement to disclose to an external auditor.
3. A right to disclose to an appropriate authority with a requirement to disclose to an external auditor if that right is not exercised.

The original paragraph 225.20 (Option one) had support, except for the last sentence requiring the termination of the relationship, for example, if a client admitted that an illegal act had occurred.

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Option two was judged unsatisfactory as the accountant should have the right to disclose a matter if the external auditor does not. Moreover, this option would allow the accountant to be absolved of any further responsibility by merely disclosing to the external auditor, which did not seem appropriate.

A preference for Option three was expressed by some Board members. It would be in the public interest for the accountant to have a right to disclose the matter to appropriate authorities, without breaching confidentiality, if the entity and the external auditor do not disclose the matter.

Other possibilities were considered, including one where the external auditor does not disclose the matter to an appropriate authority that the professional accountant believes should be disclosed. It was noted that providing for multiple possibilities could complicate the wording. The addition of the penultimate sentence of Option one (being the expectation to exercise the right) to Option 3, a reduction of the number of variables, and the need for an exception clause for both the requirement and the right were all considered.

It was noted that the auditor would only be required to disclose illegal acts that affect financial reporting or that fall within the auditor's expertise. However, because accountants providing non-audit services and PAIBs could be involved in matters beyond that, the external auditor may receive information about matters outside the areas in which they have expertise. It was noted that this was appropriate because the auditor may have better access to information and management than accountants providing non-audit services and accountants in business.

The IESBA considered a requirement to disclose for all accountants, a requirement with an exception where there is a threat of physical danger, a requirement if effective whistle-blowing protection is provided, and no requirement because of the fundamental duty of confidentiality. On balance the IESBA agreed that:

- An auditor and a professional accountant in public practice providing non-assurance services to an audit client should be required to disclose, where the client has not done so, to an appropriate authority suspected illegal acts that affect financial reporting or fall within the expertise of the professional accountant, and that are of such consequence that reporting would be in the public interest.
- Accountants performing non-audit services for non-audit clients and accountants in business shall disclose the matter to the external auditor. If the response to the matter is not appropriate the professional accountant still has a right to disclose the matter to an appropriate authority. The accountant would be expected to exercise that right.

Exception clause

The IESBA considered a clause that would apply when, in exceptional circumstances, a professional accountant should not be required to disclose the suspected illegal act and the following points were made:

- The proposal that is based on a right does not provide for exceptional circumstances. It was suggested that it should, similar to that for a "requirement." The task force did not include such an exception because a right would allow more flexibility and if the client or employer's response was unsatisfactory, resignation would be the appropriate response.
- Whistle blowing and confidentiality are both important. Drafting is particularly difficult because of differing cultural and legislative environments. Legislation could make disclosure a criminal offense. Mr. Franchini said that these issues had been considered by the Task Force and that applicable law would have precedence over the Code.
- The exception clause was intended to cover personal safety and not legal liability. However, it allows for consideration of the judicial process but it would be inappropriate to make specific reference to any lack of a fair legal system.
- It may be appropriate for the exception clause to consider harm to others, not just threats to the accountant.

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- The exception should apply if a reasonable and informed third party would consider the probable adverse consequences to the safety of the professional accountant or another individual to be sufficiently severe so as to outweigh the benefits of disclosure.
- "Legitimate authority" may be preferable to "appropriate authority." The example of a tax authority may not be helpful.
- There is a need for regulators to play a part in creating a safe reporting environment. The proposal could be used as a basis for dialogue with regulators.
- An exception clause should not be worded in a way that would enable accountants to avoid making disclosures that would be in the public interest.
- An accountant who invokes the exception clause should document the matter.
- Care will need to be taken to draft an exception clause that achieves the desired objective but does not weaken the proposal.

Public interest threshold

The IESBA considered the need for guidance on what "in the public interest" means.

Paragraph 225.11 is intended to clarify what is in the public interest, but it was unclear whether this was effective. There were further comments suggesting the manner, nature, and extent of the effect of the illegal act should be included in the wording. Mr. Dakduk thought that the public interest should be interpreted broadly.

It was suggested that suspected illegal acts for which disclosure to an appropriate authority would be in the public interest would typically involve matters that are systemic, and situations when large parts of the population are affected by safety, environmental, or health factors.

Mr. Franchini thought that the public interest threshold was appropriate, but noted that a public prosecutor may consider something to be in the public interest that the accountant did not, because accountants consider materiality but prosecutors may not. It was also noted that the meaning of public interest would be interpreted differently around the world.

The IESBA reaffirmed that an exception clause should be included in the proposal and should apply to all four categories of professional accountants. Exceptional circumstances may exist where a reasonable and informed third party would conclude that the public interest is not served by the accountant making a disclosure because the probable consequences, such as the risk to personal safety of the professional accountant or other individuals, would outweigh the benefits of disclosure.

Comments on other matters

The Task Force was asked to consider how to report a suspected illegal act where the entity did not have an auditor.

Mr. Uzuka referred the Board to ISA 250 *Consideration of Laws and Regulations in an Audit of Financial Statements*. Mr. Franchini noted that if a requirement were introduced, a conforming amendment may be needed to ISA 250.

The IESBA considered the implications of terminating a professional services engagement and the following issues were raised:

- In some jurisdictions the act of termination would in itself result in a disclosure and therefore termination should be considered rather than required.
- Termination should be required if it would be unacceptable to remain associated with a client involved in an illegal act
- To terminate an engagement without making any disclosure may not be acceptable
- Termination may not be appropriate if an individual within an entity had committed an illegal act but the entity as a whole was not at fault.

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The PIOB representative expressed his appreciation for the progress that has been made in this difficult subject and the balance that was achieved in the final position. He looks out for the final proposal. However he called attention to the need to ensure a solid regime for the “exceptional circumstances”, that have to be extensively documented, stating the reasons for non-disclosure, and providing for a safeguard that the documentation will be kept in a safe place, e.g. in the office of a lawyer under legal privilege. Otherwise there is a fear that “exceptional circumstances” may be invoked too easily and that this may lead to hollow the meaning of the standard.

The tentative decisions on the project will be discussed with the IESBA CAG members at its March meeting. The IESBA plans to approve an Exposure Draft during an IESBA meeting to be held in April by conference call.

Mr. Dakdduk thanked the Task Force and the IESBA members for their work on this challenging issue.

4. Revised IESBA Strategy

Mr. Dakdduk reported that the Planning Committee is recommending that the IESBA determine what its position is on key measures being debated in Europe and the US that are intended to improve auditor independence. The Planning Committee also recommends the IESBA examine recent publicly reported financial accounting irregularities to determine whether they have ethics implications. The activities will better position the IESBA as a leading international standard setter of ethics rules for the accounting profession, and further its objective of international convergence of national standards with those of the Code. The measures, particularly mandatory firm rotation and further restrictions on non-assurance services, under consideration by regulators and others have global implications.

By determining what its position is on the independence-related measures being debated by the EC and PCAOB, the IESBA will demonstrate leadership for member bodies of IFAC who are entitled to look to the IESBA to take the lead in determining whether their codes should be revised in light of these activities. Thus, the objective should be to determine what the Board's position is regarding the significant measures that are within its purview, whether changes to the Code are warranted, and, if so, add one or more projects to the Board's agenda to bring about those changes. Likewise, the Board should take the lead in assessing the ethical implications of recent corporate accounting irregularities and determine whether the Code could be strengthened to promote greater protection of the public interest by professional accountants in business.

The IESBA discussed the proposals and the following points were noted:

Initial Steps

The work required to develop a position on mandatory firm rotation and further restrictions on non-assurance services would be started by the Planning Committee. A project on mandatory firm rotation should also consider whether the Code's current partner rotation requirements continue to be appropriate. Specifically, the Board should consider whether the two-year time-out period should be revised. Feedback from certain of the Board's constituents suggests that the period is too short, because it would allow a key audit partner to serve on the audit for 14 out of 16 years.

In determining the appropriateness of further restrictions on non-assurance services, the Planning Committee will likely recommend that the Board consider whether the use of materiality to achieve such prohibitions continues to be appropriate. Feedback from certain of the Board's constituents suggests that prohibitions based on materiality pose challenges because of its subjective nature and the Code's lack of guidance on how to evaluate materiality.

The IESBA agreed that it should develop a position on the significant matters, mainly mandatory firm rotation and whether further restrictions on non-assurance services are needed, that are within the Board's purview and under consideration in Europe, the US, and other key jurisdictions.

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The Planning Committee will begin developing materials on these issues to initiate a discussion starting with the IESBA's June meeting.

Structure of the Code

The IESBA agreed to consider how the structure of the Code could be improved. Mr. Dakdduk noted that a trial reformatting of the Financial Interests section of the Code had been reviewed by some individuals in the meeting. The feedback suggested that the reformatting could be useful in raising the visibility of the Code's requirements and prohibitions and better explaining who is responsible for meeting them. The IESBA understands from comment letters on previous exposure drafts that structure and responsibility pose challenges in terms of the Code's enforcement and therefore its wider adoption. A subgroup of the Planning Committee will develop a "straw man" of a reformatted Section 290 for the Board's consideration at its June meeting.

Part C of the Code

The IESBA agreed to research accounting irregularities and determine whether Part C of the Code should be improved to better support an accountant's ability to respond to threats that can lead to such situations. This research would be done in 2012 to inform the IESBA's work plan for 2013/14. It would center on understanding corporate accounting irregularities and identifying their ethical implications for accountants in business.

Other comments

The IESBA members also made the following comments:

- Including current developments as a recurring agenda item would be helpful.
- Consideration of a measure, such as mandatory firm rotation, should be guided by how it will impact audit quality.
- Those charged with governance are important contributors to audit quality, although they are not subject to the Code, unless they are professional accountants in business.
- Appropriate resources are needed to support a thought leadership program.
- The need to understand barriers to convergence could be included within the strategy review.
- The importance of responding quickly to issues may be a factor in maintaining the IESBA's relevance; although the need to follow due process can slow progress, due process should not be compromised. However, the proposal to initially work through the Planning Committee should help to expedite matters.

Mr. Uzuka said that part of the corporate accounting irregularity at Olympus related to communication between the auditors but this was more a matter for the IAASB. He also referred to a study in 2006 of audit firm rotation that raised concerns about with the loss of experience and knowledge as a result of firm rotation and also the cost of change.

A strategic review also should go beyond responding to immediate issues. The IESBA could benefit by considering wider issues, such as the rise of China and South America and the impact that could have on the needs of users of the Code. The IESBA also should consider a wider range of stakeholders. Inviting external speakers to attend Board meetings and discuss their needs and work programs could enhance the Board's own work plans.

The IESBA supported the Planning Committee's recommendations.

Next steps

Materials will be prepared for the Board's consideration in June on as many of these topics as time and resources will permit. The Public Interest Oversight Board, the IFAC Board, and the CAG will be apprised of the Board's decision.

Mr. Wymeersch said he was pleased by the support for the proposed strategic changes. He encouraged the IESBA to work expeditiously on these and other projects and be alert for ways to achieve greater efficiencies.

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He commented on the Board's deliberations over the past two days. Referring to the breaches project and the matter of reporting to regulators, he thought that regulators may wish to be notified of all breaches.

He also commented on the debate on responding to a suspected illegal act, which he thought had been addressed in the right way and he congratulated the chairman and the Board.

5. IESBA Staff Documents

Ms. Munro introduced the topic. Under its terms of reference, the IESBA is required to be transparent in its activities and, in developing the Code and its interpretations, to adhere to due process approved by the PIOB. While important, the time it takes to follow due process procedures is not conducive to quickly addressing a matter that warrants the issuance of guidance that clarifies or emphasizes a matter covered by the Code. A new vehicle is needed for this purpose. The staff proposes that the vehicle be a staff document, for now called an IESBA Staff Ethics Alert.

The IESBA staff recommends that the IESBA adopt a process for developing and issuing this staff publication that is similar to how it develops Staff Q&As. This would include the staff consulting with a few IESBA members and technical advisors on the relevance of a topic and the extent of guidance that could be provided, and requesting that they review a draft of the proposed publication. Reference would also be made to the IAASB's process for issuing staff documents to employ best practices.

Process

The IESBA approved the proposed process for developing a staff publication and the following points were noted:

- Producing Staff Ethics Alerts is not expected to consume significant resources.
- "Staff Ethics Alerts" is only a proposed title; members were asked to provide alternatives.
- Identification of topics could come from:
 - Staff, the Board, or from exposure draft responses
 - A standing item on the agenda
 - A standing committee, set up for the purpose of identifying potential topics
- Proposed topics would probably be considered by the Planning Committee. If a significant number of staff documents are needed, it may indicate a lack of clarity in the Code itself.

The IESBA considered the need for and the wording of a disclaimer. The wording proposed in the agenda had been modeled after that used in the Staff Q&As. The IESBA supported the draft disclaimer in principle, although some minor changes may be needed.

First IESBA staff alert

The IESBA was asked to approve the development of an alert addressing the implications to audit quality of an auditor reducing audit fees in response to client pressure to reduce fees. Regulators from the US, UK, Australia, Canada, members of the International Forum of Independent Audit Regulators, and others have expressed concern that pressure to reduce audit fees could cause audit quality to be compromised. Regulators have indicated that they will be paying particular attention to this matter. The Code contains a section on fees and other types of remuneration in Paragraph 240.1, which the Alert could leverage.

The Board discussed what it could include in a Staff Ethics Alert on this topic. The previous Code had more discussion of this topic, and the UK has a standard that provides some guidance; both could be referred to. The Board agreed that showing a clear link to audit quality should be a

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theme for this topic. The document could also acknowledge the important role that those charged with governance have in this regard.

The IESBA agreed that downward pressure on audit fees, which could be more prevalent given the current economic environment, could create a risk of reduced audit quality and thus is an appropriate and timely topic for a Staff Ethics Alert.

6. ISA 610

Mr. Franchini introduced the topic, and welcomed Ms. Hillier, chair of the IAASB's ISA 610 Task Force.

The IAASB had a project to revise ISA 610 *Using the Work of Internal Auditors*. The objective of the project was to “revise [the clarified] ISA 610 to reflect developments in the internal audit environment and changes in practice regarding the interactions between external and internal auditors.” The issues the IAASB Task Force considered included:

- The external auditor's assessment of the competence and objectivity of the internal audit function; and
- Expansion of the scope of ISA 610 to address instances of internal audit staff providing direct assistance to the auditor.

Given the linkage with the Code, the IAASB extended an invitation to the IESBA to appoint a task force member. The IESBA accepted the invitation and Mr. Franchini was a correspondent member on IAASB Task Force.

At previous meetings, the IESBA considered the issue of internal auditors providing direct assistance and whether this was appropriate in consideration that they were not independent of the audit client. The IESBA had concluded that the threats and safeguards approach being proposed by the IAASB Task Force, by which the external auditor would perform additional review and supervision on the work of the internal auditors, gave adequate recognition to the fact that internal auditors were not independent of the audit client. In view of this, the IESBA also concluded that the definition of engagement team did not need clarification.

The IAASB issued an exposure draft in July 2010. A number of respondents to the exposure draft commented on what they perceived as an inconsistency between the use of internal auditors to perform the external audit procedures and the requirement under the Code for external auditors to be independent of the audit client. Some of these respondents expressed the view that internal auditors performing external audit procedures at the direction of the external auditor, in effect, would be part of the engagement team and the Code required that the engagement team be independent of the audit client.

The IESBA discussed the IAASB project at its June 2011 meeting and, in light of the comments the IAASB received on exposure, concluded that an IESBA Task Force should be formed to consider the comments related to direct assistance and the definition of engagement team. The Task Force met on September 5, 2011 to discuss the comments and possible revisions to ISA 610.

The IESBA discussed the IAASB project at its October 2011 meeting. The IESBA considered the issues raised by the IESBA Task Force and the IAASB's response to the comments of the IESBA Task Force in its meeting in September 2011. The IESBA recommended the following changes should be made to the ISA:

- The auditor should be required to communicate to those charged with governance the planned use of direct assistance from internal auditors;
- The definition of engagement team should be modified to explicitly scope out internal auditors providing direct assistance; and

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- The requirement regarding the prohibition of using direct assistance when there are significant threats to the objectivity of the internal auditor, should be modified to prohibit an auditor from using direct assistance if the threats to objectivity cannot be reduced to an acceptable level. This would be more consistent with the Code, which requires a professional accountant to apply safeguards to eliminate or reduce threats to an acceptable level.

At the October meeting Ms. Hillier had reported that, at the IAASB September meeting, the IAASB supported most of the proposals made by the IESBA Task Force. With respect to the last recommendation, however, the IAASB noted that the requirements in the ISAs, while often giving effect to a threats and safeguards model, have not directly introduced that concept nor used that terminology. However, in the IAASB's view, the requirements regarding the use of internal auditors to provide direct assistance collectively achieve the same objective.

After discussion, the IESBA agreed that the definition of engagement team should be modified to explicitly scope out internal auditors providing direct assistance. The IESBA also agreed that the auditor should be required to communicate to those charged with governance the planned use of direct assistance from internal auditors.

The IAASB met on December 5-9, 2011 and considered the IESBA's comments and other issues and approved paragraphs in revised ISA 610 in response to the suggestions of the IESBA. The IAASB approved the revisions to ISA 610 and planned to submit it in March 2012 to the PIOB for its consideration of due process without the proposed requirements and guidance on direct assistance, pending the IESBA's due process regarding the definition of the engagement team. The IESBA Task Force proposed the following change to the definition of engagement team to make it clear that internal auditors providing direct assistance are not considered to be part of the engagement team under the Code, and to avoid any apparent incompatibility between the Code and the ISAs:

Engagement team—All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on the engagement. This excludes external experts engaged by the firm or a network firm and internal auditors providing direct assistance on the engagement.

A similar amendment would also be made to the definition of engagement team in the ISAs and ISQC 1 so as to align with the IESBA Code.

IESBA members were asked to approve the proposed change for exposure and to provide any comments they have on the explanatory memorandum to staff.

The IESBA was satisfied that the changes made by IAASB to ISA 610 were consistent with what had been proposed by the IESBA. IESBA members also commented that the ISA is responding to normal business practices and that the constraints in ISA 610 keep usage at a level that safeguards the ability of the external auditor to exercise appropriate skepticism. It was also noted that the client has a responsibility for the auditor to be independent and therefore should also be motivated to avoid excessive use. The possibility of the need to review paragraph 290.199 was also raised.

The IESBA also agreed to insert the word "by" in the definition and to add a specific reference to ISA 610 in the definition.

The IESBA unanimously approved the exposure draft as revised:

Engagement team—All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on

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the engagement. This excludes external experts engaged by the firm or by a network firm. It also excludes individuals within an audit client's internal audit function providing direct assistance on the engagement in accordance with ISA 610 Using the Work of Internal Auditors.

Mr. Dakdduk thanked Mr. Franchini, the task force, and Ms. Hillier.

7. SME/SMP Issues

Mr. Thomson introduced the topic and welcomed Mr. Attolini, SMP Committee Chair and also a member of the IESBA SME/SMP Working Group.

At its October 2011 meeting, the IESBA received and discussed a report of the Working Group on how it might address the unique and challenging issues faced by professional accountants in small- and medium-sized entities (SMEs) and small- and medium-sized practices (SMPs) when complying with the Code. In November, Mr. Thomson discussed the report with the IESBA Planning Committee.

The report included a recommendation that the Board consider guidance on the preparation of accounting records and financial statements. It is common practice in many jurisdictions for SMPs and others providing services to SMEs to prepare their accounting records and financial statements. The Working Group determined that there is confusion about the Code's guidance on such services.

In particular, questions were raised about the meaning of the term "routine or mechanical nature" (paragraph 290.171), which is used in describing services involving the preparation of accounting records and financial statements. In that paragraph, the examples of such services describe the client's involvement with key aspects of the service (e.g., originating data, coding transactions, and determining or approving entries and account classifications). Thus, linking the examples to the term "routine or mechanical" suggests that the type of client involvement described in the examples makes the services routine or mechanical. Further, questions such as whether it is acceptable to obtain client approval after all transactions have been recorded, and whether recording a complex transaction is mechanical if the client has approved the account classification could be clarified.

Also, many did not see a link between this guidance in paragraph 290.171 and the guidance in paragraph 290.166 dealing with management's responsibility. For example, it was not clear to what extent a client's understanding of the entries for a complex transaction is relevant if the client approves the account classification. As explained in paragraph 290.166, the risk of assuming a management responsibility is reduced when an auditor or an accountant performing a review engagement "gives the client the opportunity to make judgments and decisions based on an objective and transparent analysis and presentation of the issues." This appears to be the concept embedded in the examples in 290.171.

Mr. Dakdduk and Mr. Thomson discussed this issue and recommended that the IESBA clarify:

- The guidance in the Code dealing with the preparation of accounting records and financial statements; and
- The importance of an audit or review client making the significant judgments and decisions relevant to the service based on an objective and transparent analysis and presentation of the issues.

As discussed at the IESBA meeting in October, this clarification might be achieved through Staff Questions and Answers, although that may not be as good as including the clarity in the Code itself. Understanding the Code has been identified as a challenge for professional accountants in SMEs and SMPs, particularly those whose first language is not English. Adding more guidance may be less helpful than clarifying the existing guidance in the Code.

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In any event, clarification will facilitate understanding and compliance with the Code. Highlighting the benefits of an objective and transparent analysis and presentation of the issues in this area so that the client can make the necessary judgments will help to strengthen the application of the Code.

IESBA members discussed the project proposal and the following points were noted:

- The IESBA recognized the challenges that might be created by the term "routine or mechanical" in paragraph 290.171. Addressing this would assist all accountants, not just SMPs, in applying the Code consistently when providing bookkeeping services to audit clients. While it may be unclear how extensive the need for clarification is in practice, as many SMEs are not required to have an audit, what is clear is that this provision of the Code would benefit from clarification.
- Options to provide clarity include re-drafting the provision and retaining the current text but clarifying it through the use of Q&As. Alternatively, the Board could delete the examples in 290.171 and allow accountants to make their own interpretation of the term. There are pros and cons to re-drafting the provision versus providing a staff Q&A to clarify the meaning of the term. A lengthy addition to the current text to clarify the meaning was not supported.

The IESBA approved the development of one or more Staff Q&As to provide clarifying guidance.

8. Regulatory Developments in the Netherlands

Mr. Martijn van Opijnen, Senior Policy Officer in the Audit Firms Division of the Netherlands Authority for the Financial Markets (AFM) was introduced by Mr. Dakduk. Mr. van Opijnen presented a summary of the AFM report "Incentives for Audit Quality," published in October 2011 and included in the agenda papers. Mr. van Opijnen made the following points.

Audit firms are by nature organizations with commercial interests and also are subject to audit quality requirements. This creates a tension. The report explored deficiencies in audit quality, and the independence, appointment, appraisal, remuneration, and sanctioning of auditors. Mr. van Opijnen said that application of a conceptual framework for auditor independence can lead to a wide range of judgments. The AFM conducted research to understand how large firms dealt with these issues in practice. The research covered firms with PIE audit clients.

Results regarding independence

It had not been possible to identify how many engagements firms had declined based on application of the conceptual framework to evaluate their independence. However, auditors who provided both a statutory audit and other services to the audit client and used a conceptual framework to evaluate their independence did not always carry out the same assessments or arrive at the same conclusions. Examples of business relationships with audit clients included: the development of office space, insurance services, banking services, legal services, business loans, IT services, car leasing, cleaning, and business archive management.

Long term relationships occurred regularly between audit partners and their clients, but generally the seven year rotation period was complied with. No violations of the two-year cooling off period had been identified.

Auditors generally complied with the prohibitions on having financial interests in audit clients. The AFM was unable to obtain a complete overview of the magnitude of prohibited financial interests that may have been held in breach of this prohibition. The firms were only able to provide insight into breaches that they had identified themselves.

About 30 family and close personal relationships with audit clients had been identified with six firms. All firms periodically asked partners and staff to confirm that they do not have relationships

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that would threaten their independence. However, central registers of relationships are not maintained by the firms.

There are no specific regulations regarding sponsor relationships or gifts to audit clients and the review identified a number of examples of sponsor relationships in excess of €5,000. The AFM found that firms had a variety of rules on what was acceptable regarding receiving gifts from audit clients.

The AFM found 75 instances where audit team members had joined clients, mainly in financial management roles. Several firms' policies and procedures required partners and staff to report intended employment with audit clients, required the individual to be removed from the audit, and required a review of the person's work.

There were virtually no instances of auditors holding a management position, either active or passive, with an audit client.

All audit firms that audited public interest entities monitored their personnel's compliance with independence requirements. Ten firms recorded violations of the independence rules. The firms followed up on the violations and imposed sanctions. The firms received virtually no complaints relating to their independence.

Results regarding appointment, appraisal, remuneration, and sanctioning of auditors.

Procedures are in place to appraise partners and staff before they are appointed by their firm to lead an audit, although the extent of the processes varies between firms.

AFM occasionally found that in evaluating the performance of audit personnel, those who received an "average" quality score and a "very good" score on commercial performance received a bonus. Those who scored "very good" on quality but "average" on commercial performance received no additional remuneration.

Some firms did not demonstrably take recorded violations or sanctions into consideration in appraisal and remuneration decisions.

Mr. van Opijnen concluded by saying that the AFM supports clearer, unambiguous, and more restrictive rules, which are clearly defined, eliminating room for judgment. He reported that the Netherlands had proposed legislation in process that would mandate eight year firm rotation. If approved, this could apply by 2014.

Mr. Dakdduk invited IESBA members to comment on the report's findings. They commented on:

- The relationship of principles, rules, and judgment
- The lack of a direct link in the report between the findings and audit quality.
- The extent to which audit committees have a responsibility for auditor independence and whether audit committees could have a more prominent role
- The impact that the proposed legislation would have on multinational groups and on networks of audit firms.

Mr. Dakdduk thanked Mr. van Opijnen for an informative presentation.

9. Regulatory Developments

Ms. Sapet updated the Board on developments regarding the European Commission's (EC) proposals on the statutory audit of public interest entities:

In October 2010 the EC issued a Green Paper as the first step in a process to propose legislation that would impact the role of the auditor, the governance and independence of audit firms, and the supervision of auditors. The proposed legislation was issued in November 2011. A vote is expected in 2013. The proposals have a dual objective of changing the audit market to increase

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competition and enhancing the independence of auditors. Those rule changes would go beyond the requirements of the Code

The legislation would comprise regulations and a directive. If passed, the regulations would become law throughout the European Union and apply with respect to the audits of public interest entities. A directive, if passed, would require member states to implement equivalent legislation, and would be applicable for audits of non-PIEs. At this stage it is uncertain whether the proposed regulations and directive will pass in their present form. The agenda item only considered the proposed regulations.

The proposed regulations include:

- Mandatory rotation of audit firms after six years (eight years in exceptional circumstances) or after nine years if a joint audit (12 years in exceptional circumstances) is conducted; a cooling off period of four years; and partner rotation every seven years with a three-year cooling off period.
- Audit firms, including network firms, would be prohibited from providing eight specified non-audit services that are deemed incompatible with an independent audit; four additional specified non-audit services that may create a conflict of interest may be provided with the approval of the audit committee or a competent authority; specific related financial audit services may be provided.
- The firm expressing the opinion shall apply safeguards to mitigate threats caused by the provision of non-audit services by a network firm to an entity incorporated in a third country and controlled by the audit client.
- Audit firms with revenues of more than €1.5 billion would be required to become “audit only firms.”
- Fees from related financial audit services should be limited to 10% of the statutory audit fee paid by that audit client.
- If the total fees received from a public interest entity audit client exceed 20% of the audit firm's total annual fees, or exceed 15% of the audit firm's total annual fees for two consecutive years, this must be disclosed to the audit committee.
- When total fees received from a public interest entity audit client exceed 15% of the audit firm's total annual fees for two consecutive years, this must be disclosed to the competent authority.
- Other matters included: confirmation of independence to the audit committee and in the audit report; a cooling off period of two years for key audit partners and one year for others involved in the audit; and when illegal acts are suspected the auditor must inform the client and invite it to investigate the matter.

Mr. Dakdduk thanked Ms. Sapet for her presentation.

Closing Remarks and Future Meeting Dates

Mr. Dakdduk thanked all participants for their attendance and closed the meeting.

Future Meetings of the IESBA

- April 19, 2012 – Conference Call
- June 18-20, 2012 – New York, United States
- October 15-17, 2012 – New York, United States
- December 10-12, 2012 – New York, United States