



International  
Ethics Standards  
Board for Accountants

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**Meeting Location:** IFAC Offices, New York, USA

**Meeting Date:** June 18-20, 2012

### **Breach of a Requirement of the Code**

#### **Objective of Agenda Item**

1. Consider proposed changes to exposure draft wording to address comments received.

#### **Background**

On October 24, 2011, the IESBA issued an exposure draft proposing changes to the Code related to provisions addressing a breach of a requirement of the Code. The comment period ended on January 23, 2012 and 45 responses were received.

At its February 2012 meeting in Dublin, the IESBA discussed the key issues raised on exposure. The CAG discussed the key issues and the IESBA's tentative conclusions at its March 2012 meeting. The Task Force<sup>1</sup> has met twice since February and has revised the exposure draft wording in light of the input from the IESBA and CAG members and detailed comments on exposure.

The Task Force developed a survey to solicit input from audit committee members and directors on the threshold questions regarding: communicating all breaches, timing of communication and audit committee approval of action to be taken

#### **Discussion**

##### *General Provisions*

Paragraph 100.10 addresses a breach of a provision of the Code that does not relate to independence. At the February meeting, the IESBA agreed that the Task Force should consider enhancing the wording of the paragraph to provide more context. The Task Force has reviewed the paragraph and recommends it is split into two. The first paragraph provides the reference to Sections 290 and 291. The second paragraph would be amended to require the professional accountant to evaluate the significance of the breach and its impact on the accountant's compliance with the fundamental principles. The Task Force also proposes an amendment to provide some additional examples of parties to whom the accountant might determine disclosure was appropriate.

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<sup>1</sup> Kate Spargo (Chair), Wui San Kwok, Alice McCleary and Marisa Orbea

### *Communicating all Breaches and Timing of Communication*

At the February meeting, the IESBA agreed that all breaches should be communicated to those charged with governance but there should be some flexibility on timing, possibly also allowing timing to be agreed with those charged with governance. The IESBA also noted that there had been a lack of responses to the exposure draft 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 IESBA's proposed direction was discussed with the CAG at its March 2012 meeting. CAG members generally expressed support for communicating all breaches but there were differing views on the timing of the communication. Some CAG members felt that all breaches should be communicated as soon as possible, other supported the proposed approach. It was also noted that the Code contains no de minimis threshold for prohibited financial interests.

A CAG member suggested that the IESBA obtain input from audit committee chairs and directors. A survey was developed to solicit input from these parties. The survey was posted on the IESBA website. At June 8, 2012, 429 responses had been received (see Agenda Paper 6-C for the survey and results). The majority (86%) are of the view all breaches should be communicated as soon as possible. With respect to timing, a significant minority (35%) felt that the communication should be as soon as possible. Those who felt there should be some flexibility on the timing thought communication should occur:

- As soon as possible, unless breach is clearly trivial and inconsequential (30%)
- On a timely basis, left to judgment of the auditor (24%)
- In accordance with a timeline agreed with the auditor (10%)
- Other (1%)

The Task Force considered the survey results, and the input received from CAG members at various CAG meetings. The IESBA's tentative decision at the Dublin meeting was that the timing should be agreed with those charged with governance. The Task Force is of the view that this is the appropriate approach because it increases transparency and addresses the concern expressed by some CAG members regarding the subjectivity if the decision is left to the auditor. The Task Force has developed proposed wording to provide this flexibility (¶290.46).

### *Other Issues*

#### Communication to a Regulator

Three respondents (IOSCO, ICPAR and NASBA) commented on communicating with a regulator and the matter was also raised by a CAG member. The Task Force has considered the issue and proposes an amendment to ¶290.41 to states that the firm may determine that consultation with a member body, relevant regulator or other oversight authority is appropriate.

#### Significance of the Breach

One respondent (IOSCO) noted that the last factor contained in ¶290.42 was incomplete because certain non-assurance services that may not have a direct effect on the financial statements can still create significant threats. The Task Force proposes amending the factor and including an additional factor to address this comment.

### Communication in Writing

One respondent (CICA) expressed the view that the communication should be in writing. The survey sought input on this matter and the majority of respondents thought the communication should be in writing. The Task Force proposes amending ¶290.47 to require the firm to communicate in writing the matters that are discussed with those charged with governance. The Task Force also proposes some amendments to ¶290.46 and ¶290.47 such that the communication of the firm's independence policies and procedures and the steps to reduce risk of re-occurrence is in written form.

### Approval of Those Charged with Governance

Eleven respondents (AAT, AIA, FAR, KICPA, IDW, WpK, DTT, CPAAu, ICAA, IRBA and AGNZ) stated that they did not support the proposal that the firm could only continue with the engagement if those charged with governance agree with the proposed actions. The Task Force considered that 75% of respondents to the survey agreed that audit firms should seek concurrence of those charged with governance that action can be taken to satisfactorily address the consequences of the breach. Some of these respondents also expressed concern that, as drafted, it seemed to devolve some of the responsibility to those charged with governance. The Task Force has considered the matters raised and proposes to retain the requirement but propose a change to the wording of ¶290.47 to eliminate the perception that audit activity must be suspended until the agreement of those charged with governance is obtained. The Task Force also proposes changing “agreement” to “concurrence”.

### **Effective Date**

The Exposure Draft proposed an effective date of approximately six months after approval. Responses were as follows:

	Supportive	Longer period necessary	No comment
<b>Member Body</b>	ICPAR, AIA, ICAS, CNCC-OEC, WpK, ACCA, ICAA, MIA, CND-CEC, AAT, SAICA, NASBA, ICPAS, IDW, HKICPA	CAG Canada, CICA, JICPA, AICPA, CPA Australia, KICPA, ICAP	FAR, ICAEW, ICJCE
<b>Firms</b>	DTT, E&Y, Mazars, PwC, BDO,	KPMG, GTI	
<b>Regulators</b>		CARB	IRBA, CPAB
<b>Other Prof Organizations</b>	AGNZ, NZAuASB, ASSIREVI, APESB,		FAOA, FEE
<b>Individuals</b>			DSFJ

Approximately two-thirds (24) of those who commented on the issue supported the proposed effective date. One third (11) felt a longer period was necessary. Reasons provided included: the need for translation, training requirements, some systems enhancements and time to make the change in a particular jurisdiction.

The Task Force has considered the comments and, in light of the significant minority that would prefer a longer time period, recommends that the effective date for the standard be January 1, 2014. This would provide approximately one year from the release of the standard.

## **Impact Assessment**

The responses to the impact assessment were generally supportive, though some respondents felt that the impact assessment was too lengthy. The IESBA is pilot testing impact assessment. Two other exposure drafts have been issued with impact assessments (Conflicts of Interest and Definition of Engagement Team) and there will be two additional exposure drafts with impact assessments (Responding to a Suspected Illegal Act and Those Charged with Governance). The approach taken in the impact assessments has differed with the Breaches being the most detailed and the proposed Illegal Acts the most succinct. At the next meeting of IESBA it is proposed that the IESBA, as a separate agenda item, discuss the merits of each approach and the feedback received on each approach and form a view on a consistent approach to be taken for impact assessment. Accordingly no revised impact assessment is presented in this agenda paper.

## **Next Steps**

The proposed wording, revised as appropriate to address IESBA input, will be discussed by the CAG at its meeting in September. The Task Force will revise the wording, as appropriate, to address comments from CAG members and the IESBA will be asked to approve the document at its next meeting.

## **Material Presented**

Agenda Paper 6	This agenda paper
Agenda Paper 6-A	Breaches – draft wording (clean)
Agenda Paper 6-B	Breaches – draft wording (mark-up)
Agenda Paper 6-C	Survey results
Agenda Paper 6-D	Detailed cut and paste of comments

## **Action Requested**

1. IESBA members are asked to consider the proposed changes.
2. IESBA members are asked to determine whether, subject to any changes to address issues raised by CAG members, they would approve the document at the next IESBA meeting.