

**Draft Minutes of the Meeting of the  
International Ethics Standards Board for Accountants  
June 18-20, 2012  
New York, USA**

	<b>Members</b>	<b>Technical Advisors</b>
<i>Present:</i>	Ken Dakdduk Helene Agelii Robert Franchini James Gaa Caroline Gardner Gary Hannaford Jörgen Holmquist Peter Hughes Felicitas Irungu (in part day 1, days 2 and 3) Chishala Kateka Wui San Kwok (by telephone) Stefano Marchese Alice McCleary Marisa Orbea Isabelle Sapet Don Thomson Brian Walsh	Lisa Snyder Tone Maren Sakshaug Sylvie Soulier  Tony Bromell
	<b>Non-Voting Observers</b>	Patrick Wanjelani Andrew Pinkney Elbano de Nuccio Eva Tsahurido Liesbet Haustermans
<i>Present:</i>	Richard Fleck Koichi Uzuka	
<i>Regrets:</i>	Juan Maria Arteagoitia Kate Spargo	Kim Gibson  Jean-Luc Doyle
	<b>Observing on behalf of PIOB</b>	
	Eddy Wymeersch	
	<b>IESBA Technical Staff</b>	
<i>Present:</i>	Jan Munro Chris Jackson	

**1. Introduction and Administrative Matters**

Mr. Dakdduk explained that all meetings will now be tape recorded in order to make the Board's discussions available to the public. Mr. Dakdduk opened the meeting noting that apologies had been received from Ms. Spargo, Ms. Irungu will be arriving later on Day one and that Mr. Kwok will be participating via telephone.

He invited all those observing the meeting to briefly introduce themselves.

*Minutes of the Previous Meeting*

The minutes of the February 2012 meeting and April 2012 teleconference meeting were approved, subject to certain clarifying revisions. Specifically, it was recommended that the

minutes should be clarified to bridge the gap between the Dublin meeting minutes and the subsequent teleconference meeting on Suspected Illegal Acts.

Mr. Dakdduk noted that a new policy will be put in place whereby the discussion leaders for each agenda item will be responsible for drafting the related minutes.

Mr. Dakdduk provided an update on activities since the February 2012 meeting. Several members were asked to assist with the update.

*Roundtable Organized by the Chartered Accountants Regulatory Board (CARB)*

Mr. Dakdduk noted that he, Ms. Spargo, Mr. Franchini and Richard George (Past IESBA Chair) provided a presentation as part of a roundtable session to a joint CARB/IESBA workshop with respect to various projects of the Board, including suspected illegal acts and breaches of the Code, as well as discussion of the current regulatory environment.

*Consultative Advisory Group (CAG)*

Mr. Dakdduk stated that he and representatives of the Board met with the CAG in March 2012. The CAG members were generally supportive of the Board's work streams. He also noted that the Belgian Institutes generously hosted a dinner for the group. The CAG is scheduled to meet on September 12, 2012 in the IFAC New York Office. Mr. Dakdduk encouraged Board members to attend the meeting.

*European Commission (EC)*

Mr. Dakdduk reported that he and Ms. Munro met with representatives of the EC senior staff and discussed various aspects of the EC proposals on the statutory audit of public interest entities and the IESBA Code. He noted there were a number of mutual interests and ~~on balance, that~~ it was a worthwhile meeting ~~and opened~~ opening communications with an important regulatory body.

*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) to discuss the ~~breaches~~ Board's project on Breaches of the Code ~~project~~. Members of SC 1 recommended that the Board should consider reporting such breaches to a regulator. They also stressed the importance of obtaining input from audit committees ~~on the way in which a breach was to be addressed~~. In addition, ~~there was still~~ some ~~concern~~ expressed a view that the proposed wording on breaches may be too permissive as drafted.

Mr. Dakdduk stated that he also discussed the project on responding to suspected illegal acts ~~provisions~~ with members of SC 1. It was noted that IOSCO is still forming its view and therefore did not provide any comments at this time.

SC 1 members ~~also~~ commented on the planned project relating to reformatting of the Code ~~project~~ and were pleased to hear that the Board will be addressing this issue as the prohibitions in the Code ~~are not evident~~ could be made more prominent – this would aid understanding and enforceability.

Mr. Dakdduk noted that these meetings are valuable because they enable the Board to obtain feedback as its projects progress. The next meeting of IOSCO will be held in late June and he and Ms Munro plan to attend via conference call.

#### *Organisation for Economic Co-operation and Development (OECD)*

Mr. Franchini reported that he and Ms. Munro attended the meeting of the OECD working group on anti-bribery. The working group includes representatives of the OECD countries as well as others who have implemented OECD legislation and monitors OECD legislation in OECD countries. Mr. Franchini stated that he discussed the [project on responding to](#) suspected illegal acts ~~project with the working group~~ and received positive feedback.

#### *SMP Forum*

Mr. Thomson reported that he attended the annual SMP Forum in Singapore to discuss challenges facing SMPs around the world. He noted this year's focus was on Southeast Asia. Mr. Thomson stated that he participated on a panel and explained to those in attendance that the IESBA is focused on facilitating a better understanding of the Code for SMPs and considering how best to deal with potential SMP and SME issues as projects move forward, as well as establishing possible protocols. Ms. Munro noted that the IAASB has a protocol established with the SMP Committee and she will be working to establish a similar protocol for the IESBA whereby the Board could receive timely input from the SMP Committee.

#### *National Standards Setters (NSS) Meeting*

Mr. Dakdduk reported that the NSS Meeting was held at the IFAC New York Offices [in April 2012](#) and chaired by Ms. Sapet. Ms. Sapet reported that the meeting was divided into various sessions. One session was to present the Board's activities, which included [addressing](#) breaches of the Code and ~~suspected illegal acts~~ [Responding to Suspected Illegal Acts](#), and [included a](#) discussion of recent projects added to the IESBA agenda, with the focus on obtaining input from the national standard-setters. Another session focused on reporting by the standard-setters regarding developments taking place in their jurisdictions. Presentations were also received from representatives of the Netherlands, the PCAOB, and Australia on regulatory developments in their countries and the representative from Japan reported on implementation of the IESBA Code. Mr. Dakdduk noted that the NSS participants provided a very favorable response to the meeting.

#### *Planning Committee*

Mr. Dakdduk reported that the Planning Committee met in May 2012 to discuss the various work streams as well as planning for the Board's agenda and work plan for the remainder of the year. Based on the limited human and financial resources available, as well as the proposed timing for the various projects, it was agreed that the October 2012 meeting of the Board would be replaced with one or two teleconference or Web event meetings. The Board was advised that the first two days of the scheduled October meeting should be reserved for possible teleconferences but the October 17<sup>th</sup> date could be released from Board members' schedules. Mr. Dakdduk stated that the Planning Committee discussed the current work plan and noted that certain projects will continue through 2013. Accordingly, the IESBA Strategy and Work Plan will be extended through 2013 and the document has been updated to reflect the proposed timing of the various work streams. He also noted that the Board will survey stakeholders to solicit input on its agenda for purposes of the 2014-2015 [year period](#).

Notwithstanding the budget shortfall, Mr. Dakdduk advised that the Board will be able to search for another technical manager which will help with the necessary resources. Lastly, he noted that the Planning Committee is also considering improvements to make its discussions more transparent.

#### *Outreach*

Mr. Walsh reported that the Chartered Institute of Management Accountants (CIMA) held a roundtable in May 2012 which he attended. Specifically, CIMA sponsored a roundtable based on the launch of a recent survey that was issued by a joint venture of CIMA and, the Association of International Certified Professional Accountants (AICPA). He noted that the joint venture was established to offer a new designation, the CGMA (Chartered Global Management Accountant). The survey explored business ethics of professional accountants in business and the specific challenges faced by such accountants. He reported on the survey results, which included increased pressures faced by professional accountants in business to perform unethically, especially in emerging markets. Mr. Walsh noted the report is available on CIMA's Website.

Mr. Marchese reported that he represented the IESBA at the European Federation of Accountants and Auditors (EFAA) conference in Rome on May 8-9, 2012. He explained that the discussion focused on the financial crisis in Europe and the roles of the various players. Also discussed was the role of financial reporting and ethical behavior. He added that he presented the various projects of the Board and that ~~that~~ the conference was well attended with wide representation. ~~— Mr. Fleck noted he spoke at this conference as well.~~

#### *Statements of Membership Obligations (SMOs)*

Mr. Dakdduk noted that ~~a best endeavors approach had been considered for the SMOs, including previous version of SMO No. 4 (which relates to the IESBA Code of Ethics), included a requirement that member bodies should not apply less stringent standards than those stated in the Code~~ and that the ~~Interpretation had recognized the use of a “best endeavors” approach. The IESBA previously had concluded that such an approach was inappropriate unclear.~~ He reported that ~~the revised SMO clarified that for those IFAC member bodies that have direct responsibility for standard-setting, the the member body should not apply less stringent standards than those stated in the Code. The best endeavors approach was removed. It was however maintained for those member bodies that do not have directis to be applied where the member body has no responsibility for the area, and those with shared responsibility shall implement those requirements for which they are responsible.~~ The IFAC Board discussed this matter last week and it is expected that the IFAC Compliance Advisory Panel (CAP) will approve the revised SMOs in July 2012. It is also expected that the IFAC Board will approve the revised SMOs in the Fall and they will then be ratified by the IFAC Council.

#### *Public Interest*

Mr. Dakdduk reported that IFAC had revised the policy position paper defining the “public interest” and Ms. McCleary, Mr. Gaa and Mr. Kwok had reviewed the revised position paper on behalf of the Board. Ms. McCleary reported on the comments received and noted that while there was improvement, the underlying structure problems with the paper remained. Specifically, she noted that there still was uncertainty as to who should apply the proposal and there was not

enough narrowing of the scope. In addition, the proposal still referred to a framework definition rather than a definition framework and the overall objective of the paper was still not clear. Ms. McCleary also noted that the definition of who is considered to be the public was still a matter of concern to the sub-group.

Mr. Dakdduk noted that IOSCO's comment letter on conflicts of interest suggested the Board address the public interest more fully in the Code. He recommended that at the Board's December meeting, the Board fully discuss the issue of public interest and possibly consider whether a broad project should be added to its agenda on this issue.

#### *Staff Alerts/ Q&As*

Mr. Dakdduk reported that staff Q&As, including some addressing bookkeeping, had been were developed and emailed to the Board last week for input. Some revisions were expected. He explained that the Board does not approve Q&As issued by Staff but feedback is welcome. In addition, the first Staff Alert will be developed on fees ~~and is scheduled to be issued this summer.~~

#### *Engagement Team Definition*

Mr. Dakdduk advised the Board that the comment deadline for the engagement team definition exposure draft has just ended and 44 responses had been received to date. Thirty-seven respondents supported the proposal while 5 were opposed (i.e., did not support the concept of internal auditors providing support to the external auditor). Staff is currently working with the IAASB to review all comments. It was noted that the IOSCO letter is still pending.

#### *Impact Assessment*

Mr. Dakdduk noted that the Board has been trying to determine the best way to assess the impact of its proposals. He recommended that the Board consider its experience with the impact assessments and the comments received on them. Based on such experience, the Board should be able to determine the best model for analyzing impact assessments. He noted this issue is expected to be discussed by the Board at the December 2012 meeting.

#### *Annual Report*

Mr. Dakdduk informed the Board that the 2011 IESBA annual report was issued last week and is available on the IFAC Website. This document will also be available in print format so members can distribute it when providing outreach.

#### *PIOB*

Mr. Dakdduk reported that the PIOB issued its seventh annual report in May 2012. Mr. Wymeersch noted that the report provides the various work streams of the PIOB as well as detailed information on various meetings attended.

#### *Survey of Audit Committee members*

Mr. Dakdduk reported that a survey washad been conducted ~~on~~ of audit committee members. Ms. Munro explained that the survey was conducted by the Breaches of the Code Task Force to focus on key issues and questions ~~of~~ the Task Force faced in developing the Board's proposals. To date, 499 responses have been received and the Task Force was pleased with the responses and believed this was an effective way to get targeted input from key stakeholders. She noted

such surveys could be used by other task forces when in need of specific input from certain constituents to supplement input on an issue.

#### *New IFAC CEO*

Mr. Dakdduk informed the Board that Ian Ball's successor has been announced. Mr. Fayezul (Fayez) Choudhury has been selected as the new CEO of IFAC and will succeed Mr. Ball, whose term is set to expire in February 2013.

#### *Future Meetings:*

December 10-12 AICPA offices, New York

March 11-13, 2013 ~~(TBD)~~ IFAC offices, New York

June 10-12, 2013 -IFAC offices, New York

Sept 16-18, 2013 IFAC, New York ~~(TBD)~~

Dec 4-6, 2013 -IFAC offices, New York

## **2. Responding to a Suspected Illegal Act**

*The discussion on ~~illegal Acts~~ this project was held in three sessions during the IESBA meeting in New York, one each day of the meeting, allowing the Task Force to ~~provide new~~ develop revised proposals and responses to comments between the sessions.*

Mr. Franchini introduced the topic and the background issues.

He noted that the Task Force's proposals were discussed by the IESBA at its February meeting in Dublin and during its April conference call. The Task Force met on June 5, 2012 to consider the input received from the IESBA and CAG members and to revise the proposed wording for the sections addressing professional accountants in public practice (section 225), professional accountants in business (section 360) and changes to other sections of the Code.

In particular, he presented the two key issues that the Task Force addressed following the April teleconference call:

- New language for the exceptional circumstances in 225.13 (accountants providing services to audit clients), 225.19 (accountants providing services to non-audit client entities), 225.20 (accountants providing services to non-audit clients that are individuals) and 360.9 (professional accountants in business).
- New language to define the "audit client" for the purposes of this guidance in the context of a group audit.

Before discussing those two matters in particular, it was noted that some stakeholders may find it difficult to understand the difference between situations where there is a requirement to disclose and situations when there is a right with an expectation to disclose, especially when exceptional circumstances are taken into consideration.

The IESBA considered CAG members' comments regarding the responsibility of an auditor to evaluate what is in the public interest and whether auditors have a higher level of responsibility than other accountants with respect to the public interest. Mr. Franchini explained that the CAG

members expressed diverse positions. Some CAG members viewed the public interest to be as important for non-auditors as for auditors while others thought that auditors had a more significant public interest role than non-auditors. He agreed that it was difficult to reconcile the two views and that the Task Force, having further considered the issue, has reconfirmed its position that it is appropriate to set a requirement for auditors and a right for other accountants. Mr. Franchini noted that, while all professional accountants should act in the public interest, the primary responsibility of auditors is to safeguard the interest of users of financial statements while the role of professional accountants providing non-assurance services and professional accountants in business is more of a fiduciary nature with respect to the client or employer.

It was noted that in a number of paragraphs there is a reference to the external auditor and that a number of companies may not have an external auditor. It should be acknowledged that such situations happen and the Code should be clearer that the escalation process is still needed if there is no appropriate response, in the absence of an external auditor. Mr. Franchini agreed and “if any” will be inserted each time there is reference to the external auditor.

| ~~The~~ IESBA members raised a number of other matters:

- Whether the escalation process should apply to all suspected illegal acts, but the disclosure only apply to a limited number of illegal acts.
- Whether the area of “expertise” of the accountant should be replaced by the area of “competence”.
- That referring to an ethics policy in paragraph 360.5 would not be a sufficient mechanism as there is no guidance as to what should be in such ethics policy.
- A number of editing comments.

| Mr. Franchini noted that the IESBA had discussed in prior meetings the nature of suspected illegal acts that should be subject to the escalation process and those that should ultimately be subject to reporting. Based also on input from the CAG members it had been determined that all types of suspected illegal act should be subject to escalation because an entity should respond appropriately to all suspected illegal acts. However, only those items related to financial reporting or within the scope of the expertise of the professional accountant should be subject to reporting to an appropriate authority. In addition, the IESBA agreed that the scope should be limited to the expertise of the specific professional accountant involved rather than the expertise of all professional accountants as it is important to recognize the wide range of specialization of accountants and it would be unrealistic to expect that professional accountants are experts in all matters.

The Task Force had received a comment from the Small and Medium Practices Committee that more guidance should be provided on what constitutes a “suspected” illegal act. Mr. Franchini explained that the Task Force did not believe that providing such additional guidance was necessary but that the point could be addressed in the Explanatory Memorandum. It was also noted that additional guidance can be found in ISA 240 (The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements).

Mr. Franchini agreed that the reference to an ethics policy, in paragraph 360.4, was not an appropriate mechanism, but the paragraph should refer to mechanisms such as an ethics hotline.

The PIOB representative, Mr. Wymeersch, recognized the focus of the guidance on financial reporting, but also mentioned that there would be other situations to be reported, such as, for instance, if the entity has no audit committee which may breach an applicable law. Mr. Franchini said that he would consider this to fall into the area of expertise of an auditor, and therefore within the scope of the matters to be reported, but agreed that it would be useful to mention this point in the Explanatory Memorandum.

The Japan FSA representative, Mr. Uzuka, explained that when reporting to the appropriate authority is required or expected, it should be done in a timely manner. Mr. Franchini confirmed that the requirement to “act reasonably” or take “reasonable steps” would encompass “acting in a timely manner”.

#### *Exceptional circumstances*

The IESBA confirmed its agreement with the limited exception provision in exceptional circumstances, but also agreed that the circumstances not be so widely defined so as to provide an easy way to circumvent the requirements. Accordingly, at the suggestion of one member, the IESBA agreed that the wording “When the circumstances are sufficiently severe...” should be changed to “When the circumstances are so severe...” The IESBA also agreed that a commercial reason is not an acceptable reason not to disclose a suspected illegal act, that the word “financial” could be ambiguous, and provided input to improve the wording.

The IESBA discussed whether the changes regarding “commercial nature” in section 225 should be reflected in Section 360, with respect to professional accountants in business. Mr. Franchini concluded that the “commercial nature” concept did not apply to professional accountants in business and also reminded the IESBA that section 360 refers to a right to disclose and not a requirement, and so it is not necessary to provide the same level of precision in each situation.

#### *Group Audit Situations*

In the April conference call the Board asked the Task Force to consider whether the guidance as drafted may have unintended consequences in group audit situations, particularly where an audit firm and its network is responsible for the audit of only a part of a group of companies. Mr. Franchini explained that the Task Force had considered this scenario and noted that, for listed entities, the audit client, as defined by the Code, includes the parent company and entities under common control. Accordingly, a suspected illegal act discovered in an entity under common control by a network firm performing non-audit services would be subject to the same escalation process as a suspected illegal act encountered in an entity being audited by the audit firm. The Task Force believed that in such situations the guidance for auditors did not seem appropriate in the context of a suspected illegal act that may have been discovered by a network firm in an entity under common control. Rather it seemed more appropriate to address such situations by applying the guidance for professional accountants performing non-audit services to a non-audit client. Accordingly, wording had been included in the proposed guidance to clarify that “audit client” for the purposes of this proposed guidance is the entity in respect of which a firm conducts an audit engagement and related entities over which the client has direct or indirect control. There was general agreement by the IESBA with the proposals of the Task Force to adjust the



definition of the audit client, for this purpose, to the entity that is being audited and its subsidiaries.

Mr. Wymeersch ~~noted~~stated a view that when a suspected illegal act is found at a subsidiary level, in situations where a significant problem is identified, there should be a requirement to report to the parent company, even if the parent company is not the client of the accountant. Mr. Franchini confirmed that since the escalation process included reporting to those charged with governance, it would normally include representatives of the shareholders and the parent company.

Mr. Dakdduk proposed this point could be clarified in the Explanatory Memorandum, which was agreed by the IESBA.

#### *Termination of the relationship*

Mr. Wymeersch thought that the proposed guidance as currently written appeared to suggest that the accountant could avoid reporting by terminating the relationship with the client or employer. After some discussion it was agreed that the wording contained in paragraph 225.8 (Agenda Paper 2-B) may be interpreted in this way although that was not the intent.

The Task Force proposed a wording addressing the possibility of termination/resignation at the beginning of sections 225 and 360, respectively, and explicitly clarifying that termination is not a substitute for disclosure.

~~Mr. Franchini also suggested that the Explanatory Memorandum could include a flowchart to help readers understand how the escalation process works, including up to a potential resignation.~~

#### *Documentation*

The IESBA discussed whether all suspected illegal acts situations should be documented by the accountant in all cases. The IESBA noted that the documentation requirement has no materiality test, and relatively small matters, such as pilfering small amounts of petty cash, would require a disproportionate amount of documentation, and that this could be a problem in certain jurisdictions as the documentation could be subpoenaed and used against the accountant and the client. ~~On balance the~~The IESBA was of the view that ~~there would be potential risks in not requiring maintaining~~ documentation ~~for every case~~is in the interest of the professional accountant.

The CAG chair acknowledged that it was a difficult balance to achieve, but he saw benefits in having the accountant document why he or she concludes that disclosure is not in the public interest and, even in relation to small matters, it would be important to be able to identify if it is recurrent. His conclusion was that it is better to document everything, including the nature of the matter and why there is a decision not to report. He also noted that ISA 240 requires documentation and he was not aware of this being a problem.

Mr. Franchini added that it was expected that the level of documentation would be commensurate with the gravity of the suspected illegal act. It was noted that in a number of jurisdictions,

documentation provides a protection for auditors. Mr. Franchini agreed to raise this specific point in the Explanatory Memorandum.

The IESBA also raised the issue of the custody of this documentation. The representative of the PIOB asked for a strengthening of the documentation provision by requesting documentation to be filed with a lawyer or a Member Body, noting that it would also empower Member Bodies. The IESBA noted that this would be inconsistent with other sections of the Code requiring documentation which do not state with whom documentation should be filed.

Mr. Uzuka noted that the quality of the documentation was important and asked whether the ISQC1 standard would apply to documentation required under the proposal on suspected illegal acts. Mr. Franchini said that ISQC1 applies to all documentation prepared by auditors.

#### *Changes to other sections of the Code*

A Board member asked whether the proposed changes to Section 300 of the Code should be considered as part of the Part C revision project and to consider all changes to Part C at the same time. Mr. Franchini noted that the point on unethical behavior had been extensively discussed by the IESBA and the CAG members in prior meetings and as the proposals were an integral part of the proposed guidance it would not be appropriate to exclude these proposed changes from the exposure draft.

Mr. Dakdduk expressed the view that if the wording in Part C can be improved, it should be done at this time, and reminded the IESBA that the Part C project would be undertaken in 2014-16. The IESBA agreed with this view.

The IESBA also performed a paragraph by paragraph review and provided suggestions for a number of edits and wording improvements.

#### *Vote*

The IESBA agreed a final draft of the proposal, subject to minor edits, and voted in favor of issuing the Exposure Draft. 15 members voted in favor of the Exposure Draft and 2 members voted against. One member was absent.

Mr. Dakdduk invited the two members who voted against the proposal to present their rationale.

Ms. Orbea explained that in her view, the role of the Code of Ethics is to clearly set out the values, principles and expectations that, together with the application of professional judgment, should guide a professional accountant's choices and actions, especially when faced with competing obligations. She fully supported the provisions that seek to establish that, when faced with a significant suspected illegal act by a client, a professional accountant not only has the *right* to put their responsibility to act in the public interest ahead of the competing ethical obligation of confidentiality, but is also expected to exercise that right in certain circumstances. However she did not support the provisions that establish an *obligation* for a professional accountant to report a suspected illegal act by a client to a third party outside the client, regardless of the circumstances, as there are no means for the Code of Ethics to provide the protections that must necessarily accompany such a serious obligation. The legal and ethical implications of imposing such an

obligation are so complex, the jurisdictional issues so diverse, and the personal impacts so potentially severe, that she considered the regulation of whistleblowing to be the sole responsibility of those in each jurisdiction (e.g., legislators) who have the authority to accompany such a serious obligation with the appropriate protections.

Ms. McCleary explained that for an accountant, keeping the trust of a client is a key element and she had strong concerns that the proposal would put some accountants in difficult situations, without legal protection but with a requirement to report and disclose certain matters and breach their client's trust. In her view, this is contrary to the public interest. She agreed with breaching a client's trust when required by law, but not voluntarily.

*Comment period and effective date*

Mr. Franchini noted that given the importance and nature of the proposal and also because the Exposure Draft would be issued during the summer, he would recommend extending the 90-day standard period to a 120-day period. He also explained that this would mean there would not be sufficient time for the Task Force to consider the comments and present an analysis for the December meeting. He asked the IESBA for their views.

The IESBA agreed that considering the complexity of the issue, and the need for some Member Bodies to translate the proposal, it was a reasonable proposal, although it was unfortunate that no discussion would be held before the March 2013 meeting.

Mr. Dakdduk suggested that the IESBA could hold a call in January or February to present the preliminary analysis, but some members doubted that this would be the most effective way to deal with the issue.

The IESBA agreed that the comment period would be 120 days.

Regarding the effective date of the provision, the IESBA agreed that one year should be sufficient, but also agreed to include a specific question in the Explanatory Memorandum.

Mr. Franchini closed the discussion by thanking the members of the Task Force, the IESBA staff and the members of the IESBA for their work and input.

Mr. Dakdduk also thanked the chair of the Task Force, Mr. Franchini, and the other Task Force members for their work and their patience.

### **3. Conflicts of Interest**

Mr. Hughes introduced the topic.

The Code currently contains two sections that address conflicts of interest, Section 220 for professional accountants in public practice and Section 310 for professional accountants in business.

Extant Section 220 states that a professional accountant shall take reasonable steps to identify circumstances that could pose a conflict of interest and that such circumstances may create threats to compliance with the fundamental principles. The section also states that a professional accountant shall evaluate the significance of threats and apply safeguards to eliminate them or reduce them to an acceptable level. Potential safeguards are provided in the section and it is stated that, depending on the circumstances giving rise to the conflict, obtaining consent from all relevant parties is generally necessary. If threats to the fundamental principles cannot be eliminated or reduced to an acceptable level or consent is refused by the client, the professional accountant shall not accept a specific engagement or shall resign from one or more conflicting engagements.

Extant Section 310 of the Code describes a professional accountant's responsibility to an employing organization and professional obligations to comply with the fundamental principles. Certain examples are provided of where these two requirements might be in conflict and certain pressures a professional accountant in business may face. The section provides examples of safeguards that may be applied to reduce the threats to the fundamental principles that might arise from a conflict of interest.

Failure to identify and address conflicts of interest on a timely basis may result in an accountant having to withdraw from an arrangement at a point in time where the affected parties have insufficient time to effect an orderly transition to an alternative service provider. In October 2009, the IESBA approved a project proposal to provide additional guidance for all professional accountants in identifying and addressing conflicts of interest. The purpose of the project is to examine Sections 220 and 310 and revise them to provide more comprehensive guidance in identifying, evaluating and managing conflicts of interest. The exposure draft was issued in December 2011 and 50 responses were received by June 2012.

The task force met on May 14 & 15 in person and subsequently by conference call to review the comment letters on the exposure draft. The focus of these meetings was to consider the range of views from the respondents to the exposure draft and to identify common themes. The task force did not request detailed drafting suggestions from the IESBA but proposed some changes to show how the task force intends to respond to comments.

A letter was received from the International Organization of Securities Commissions (IOSCO) that identified issues pertaining to the public interest more generally and it was agreed by the task force that this is something that the Board may wish to consider more specifically at a future Board meeting. The task force was of the view that this matter was outside its mandate pertaining to conflicts of interest. The matter was raised by Mr. Dakdduk in his introductory remarks and it was proposed that this matter be considered in the December 2012 meeting of IESBA.

#### *Structure of the Section*

The task force considered feedback received from a number of respondents and proposes to revise the order of the paragraphs in the section. The Board was supportive of the restructuring.

#### *Description of Conflicts of Interest*

Extant Sections 220 and 310 do not describe a conflict of interest or provide examples of conflicts of interest. The exposure draft includes a description of circumstances that might create a conflict of interest for the professional accountant together with examples of such circumstances. The purpose is to help the professional accountant to identify a potential conflict of interest at a sufficiently early stage to be able to take any actions necessary to comply with the fundamental principles. The description developed for this purpose specifically includes conflicts between:

1. The interests of two or more parties for whom the professional accountant undertakes professional activities; and
2. The interests of the professional accountant and the interests of a party for whom the professional accountant undertakes a professional activity.

The exposure draft includes a description of a conflict of interest in paragraph 100.17 and in each opening paragraph of Sections 220 and 310.

The task force considered whether respondents found the description and examples helpful.

There was support for the proposed approach from respondents. Six respondents preferred the use of a definition of conflicts of interest rather than a description and examples. However, no respondents provided a proposed definition. Many respondents commented on the examples. The task force agreed to add some examples and to re-order the examples from the less obvious to the obvious.

The task force was of the view that the description should show the linkage between the professional service provided by the professional accountant and the matter that was in conflict between the two parties and proposed a revised description. There was general support for the revised description from the Board.

It was noted that

- the wording of the second bullet of the revised description would be clearer if it included a reference to the relationship between the professional accountant and the client that creates the conflict.
- the examples could be reviewed to ensure they are consistent with the revised description.

#### *Reasonable and informed third party standard*

The proposed revision to Section 220 requires the professional accountant to take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at that time, would be likely to conclude that compliance with the fundamental principles is compromised. This would be required both when identifying and evaluating conflicts of interest and when implementing safeguards to address them. In the IESBA's view it is appropriate for the professional accountant to consider how a conflict of interest would be viewed by a third party. Additionally, this is consistent with the application of the conceptual framework and the determination of whether threats to compliance with the fundamental principles are at an acceptable level.

The task force considered the responses to the reasonable and informed third party standard and noted that of 36 out of 41 respondents agreed with the proposal. Some respondents suggested that the third party test is subjective and a matter of judgment. The task force proposes to emphasize that the professional accountant needs to exercise professional judgment. The Board cautioned that references to professional judgment should be consistent with references in other parts of the Code.

The task force is of the view this section should conform to 100.2 (c) in that “compliance with the fundamental principles is not compromised”. This was generally supported by the Board.

There was support from the Board to the use of the reasonable and informed third party standard.

*“Reason to believe” threshold for network firms in evaluating conflicts of interest*

The IESBA considered what threshold should apply with respect to potential conflicts of interest that might be created by the interests and relationships that a firm, that is a member of a network of firms, has with a client. The exposure draft proposes that potential conflicts of interest within a network of firms should be evaluated when the professional accountant has reason to believe that a conflict of interest exists because of interests or relationships that another firm in the network has with a client. The “reason to believe” threshold requires the professional accountant to consider the facts available to the professional accountant at that time.

The task force considered the responses to the reason to believe threshold and noted that 31 out of 42 respondents agreed with the proposal.

It was noted that:

- Six respondents suggested that the threshold should be strengthened to a “reasonably be expected to know threshold”
- Two respondents suggested that the threshold was too strong
- One respondent noted that the reference to the “reason to believe” threshold should be made more prominent and the task force is of the view that the threshold should be treated as a separate paragraph and “knows or” be added to “has reason to believe” but otherwise proposes to retain the threshold as proposed in the exposure draft.

The board agreed with the general approach proposed by the task force for a “knows or has reason to believe” threshold.

*Safeguards to manage conflicts of interest and obtaining and documenting consent*

The exposure draft expands on the guidance in the extant Code regarding the nature of safeguards that may be available to manage conflicts of interest within firms. The IESBA believes that it is generally necessary to disclose the nature of the conflict to the client and all known relevant parties and to obtain written consent from the client and such parties before performing the professional service. Implicit in providing consent is that the consenting parties believe the firm can carry out the activity in compliance with the fundamental principles in the Code, particularly objectivity.

The exposure draft recognizes that in certain circumstances the consent obtained from any relevant party may be implied by the party's conduct in keeping with common commercial practice. The exposure draft also encourages the professional accountant to document such consent when it is obtained verbally or implied by the party's conduct.

The task force noted majority support for the proposal but that there were a number of specific comments regarding a lack of clarity in some terms used in the guidance e.g. "generally necessary" and some suggested a need to split out disclosure and consent. Some respondents questioned whether consent itself is a safeguard and the task force agreed not to describe it as such.

The IESBA agreed that the following changes would increase the clarity of the paragraph:

- subdivide disclosure into "specific" and "general"
- analyze consent into verbal, written and implied
- place examples of safeguards in a separate paragraph
- add an example of when implied consent might be acceptable
- provide more guidance on when a specific request would be required
- use the term "explicit" consent rather than "specific" consent

The task force does not propose to strengthen the encouragement to document consent.

The IESBA requested the task force consider:

- whether more guidance can be provided on implied consent, including an example. It was noted that implied consent occurs very rarely in practice and that consent is normally general or explicit/specific. A suggested example of implied consent was where a party asks the professional accountant to analyze financial information on all parties in a multi-party dispute and where the instruction itself provides evidence of consent to any perceived conflict.
- whether there are particular issues in relying on consent where the conflict of interest arises from an interest of the professional accountant themselves, given that self-interest should not be allowed to influence a professional accountant's judgment and there may be few safeguards available in such a situation.
- if it is necessary to disclose and obtain consent if safeguards have already reduced the threats to an acceptable level.

#### *Obtaining consent when disclosure would breach confidentiality*

The exposure draft recognizes that in certain circumstances the professional accountant will not be able to obtain consent because requesting consent would in itself result in a breach of confidentiality.

The exposure draft provides that the firm shall only accept an engagement in such circumstances if certain conditions are met. These conditions are:

- The firm does not act in an advocacy role for one client which is adversarial to the interests of another client;
- Specific mechanisms are in place to prevent disclosure of confidential information between the engagement teams serving the two clients; and

- The firm is satisfied that a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at that time, would conclude that it is appropriate for the firm to accept the engagement in the particular circumstances.

The task force considered the responses to the provisions when disclosure would itself be a breach of confidentiality and noted that 36 of 45 respondents agreed with the proposal. The task force proposed that:

- the wording should explicitly recognize that the situation is “exceptional”
- the third condition above should be strengthened to require that inability to perform the service would produce a disproportionate outcome for the client or other relevant third parties.
- documentation should be required.

The IESBA requested the task force to consider:

- clarifying that the provision would not apply where implied or general consent has already been obtained;
- whether it is appropriate to strengthen the third condition to the extent of requiring there to be a disproportionate outcome in the event that the work cannot proceed.

#### *Matters Specific to Professional Accountants in Business (PAIB)*

The material in extant Section 310 addresses conflicts of duty rather than conflicts of interest as described. As this material is already addressed in other sections of the Code, the exposure draft proposes to delete the content of the extant section and replace it with guidance for professional accountants in business on identifying, evaluating, and managing conflicts of interest.

Proposed Section 310 requires the professional accountant in business to be alert to all interests and relationships that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, might compromise compliance with the fundamental principles.

Proposed Section 310 requires the professional accountant to understand the nature of the relationships and activity in identifying whether a conflict of interest exists or may be created. It also requires the professional accountant to evaluate the significance of the relevant interests or relationships.

In proposing revisions to Section 310 to address conflicts of interest, the IESBA recognizes that professional accountants in business may encounter other threats to compliance with the fundamental principles. Certain ethical conflicts might arise, such as undue pressure and self-interest threats, when preparing financial information. The IESBA notes that these types of ethical conflicts are addressed in Sections 320, *Preparation and Reporting of Information*, and 340, *Financial Interests*, of the Code. The IESBA has made some conforming changes to these sections to improve the alignment between those sections and Sections 220 and 310.

The task force noted that some respondents did not respond to questions specific to PAIBs. Those that did respond showed support for the principles arising from these questions and all



respondents except one supported the conforming changes to 320 and 340. The task force did not identify any points of principle arising from questions specific to PAIBs and requested no direction from the Board at this time but would request the Board's input at a future meeting.

#### 4. Strengthening Safeguards Against Familiarity Threats

Ms. Gardner introduced the topic and provided an overview.

At its February Board meeting, IESBA had agreed to take on an additional work stream, including consideration of whether the current position on partner rotation set out in the Code remains an appropriate way of safeguarding against familiarity threats to the audit, arising from long standing relationship with the audit ~~relationships~~client. There have been a number of regulatory developments in this area and the IESBA agreed that it was appropriate to re-consider this issue.

A working paper to guide the Board's discussions included references to three areas of potential consideration: partner rotation; mandatory audit firm rotation; and mandatory tendering.

##### *Partner rotation*

The code addresses the familiarity threat for Public Interest Entity (PIE) audits through requiring partner rotation. There is a requirement for key audit partners, including the audit engagement partner and Engagement Quality Control Review ~~a key audit~~ partner to rotate off after serving seven years and observe a two year time-out period. Many jurisdictions use seven or fewer (often five) years as the maximum period, and two or more (often five) years as the time-out period.

In terms of refreshing the Board's view, the key points are the time on and time-out periods, the definitions of the partners covered and the entities covered.

##### *Mandatory Firm Rotation (MFR)*

The European Commission (EC) proposals include a requirement for mandatory firm rotation after six years (nine if there is a joint audit) with a four year time-off period, for PIE audits. The proposals are in addition to the existing partner rotation requirements. The USA PCAOB also issued a concept release which included the possibility of MFR, as a potential response to concerns about audit skepticism. The academic evidence that exists tends to be against MFR, but is based on little~~limited~~ practical experience. The IESBA agenda paper noted some of the theoretical arguments for and against MFR:

- The key arguments for MFR are improved perception of independence, no evidence of harm to audit quality, and bringing fresh eyes to the audit ~~and possibly lower fees~~.
- The key arguments against are a greater risk of audit failure in early years, international logistical challenges, possible increase in costs, increased market concentration, the impact on staff recruitment and retention, and impinging on the audit committee role.

##### *Mandatory Tendering*

Mandatory tendering is advocated by the E.C. ~~as well as MFR in addition to MFR~~. The E.C. proposal in effect ensures a formal tender process when firms are rotated. The UK Financial Reporting Council is advocating tendering on a "comply-or-explain basis". However there is little academic or other evidence in support of or against this requirement. The theoretical arguments for and against mandatory tendering noted in the agenda paper are:

- The key arguments for, include reduction of the perception of a familiarity threat, promotion of audit committee judgment about the balance of familiarity and inexperience, and possibly improved competition.
- The key arguments against, include restriction of auditor performance evaluation, a possible increase in market concentration, a possible increase in costs for auditor and company, and a possible effect on audit quality after a change.

#### *Board discussion*

The Board reiterated its view from the February meeting that its analysis should be guided by an overarching objective of improving audit quality. The discussion highlighted the complexity of the issue, with the arguments finely balanced. The following additional points were noted:

- While there was a clear rationale for the approach in the extant Code for partner rotation at the time it was approved, ~~circumstances have changed~~views on this in the regulatory community have moved on and the length of the on and off periods need to be reconsidered, as well as the scope of who is covered by the requirement and the roles of the various partners on an engagement, and whether requirements should cover all senior audit personnel. ~~Research by the Audit Inspection Unit in the UK has suggested that audit quality is worse in the third and fourth years of an engagement partner's period on the audit than in the first, second and fifth years. (UK standards require a maximum 5 year period for the engagement partner).~~ It was noted that it would be helpful to understand why regulators in different jurisdictions have chosen the periods they have.
- Mandatory firm rotation can create practical issues for smaller auditors and smaller countries. It was also noted that the potential quality problem in early years caused by a change in auditors would be likely to be most acute in the largest and most complex companies e.g. banks, which are the companies that regulators are most concerned about. In addition the number of alternative auditors for complex companies in some jurisdictions may be very limited, presenting a practical problem for the audit committee. A variety of approaches is adopted by those countries which have MFR and it would be useful to understand the rationale for these differences. The Italian experience of MFR was noted, where it was not perceived as having ~~affected~~detrimentally affected quality overall, but it has resulted in fee pressure and there is little evidence of any positive impact on audit quality. It was also noted that a familiarity threat is between people and that the threat may differ depending on staff turnover within the client. ~~The~~Management turnover can reduce the threat. Conversely the example was given of Italy where companies have management who are often also significant shareholders, reducing turnover, and therefore the threat of familiarity may be greater.
- Some practical issues were noted. Companies may look at rotation at times other than when it may be required as they may monitor when their competitors are considering or required to change audit firm or partner in order to know when an audit firm or partner may become available. It was also noted that the choice of audit firm is usually taken at group level and that operating subsidiaries would be expected to comply with the head office decision.

- It was noted that ~~mandatory~~ tendering, on a “comply or explain basis”, is being introduced in the UK from 1 October 2012 for the largest 350 listed companies. This may produce useful evidence in a year or two. Anecdotally, audit committees who have undertaken tendering have found it time consuming and costly but informative. The risk that reduced fees could result in auditors cutting corners and the consequent effect on audit quality was highlighted by some findings by, for example, UK and Canadian audit inspections.
- It was unclear how the Code could require firm rotation or tendering if the IESBA favored either of these alternatives because these would be regulator or management decisions respectively and the Code has no power to require companies to comply.
- The issue of mandatory firm rotation ~~arose~~ is being addressed because of a perception that relationships between auditors and their clients ~~were~~ are too close, ~~therefore the matter needs to be addressed. Any review should take into account all of the issues raised and other areas of potential concern and safeguard. perceptions can become realities.~~
- It was noted that there is a risk that independence becomes an end in itself because there is a lack of evidence that audit failure has been demonstrated to be caused by a lack of independence. The existence of fee pressures within audit firms was noted but considered to be a broader issue than being considered under this topic.
- A review being undertaken in Canada of a ~~quinquennial~~ “Mandatory Comprehensive Review” every five years of the auditor was noted. Tendering would not be compulsory but if a change is necessary the incumbent auditor would not be allowed to bid. The progress of this review will be followed.

The ~~Board's overall tentative conclusion was that at this stage~~ Board recognized the arguments on ~~MFR both sides and mandatory tendering were too finely balanced and the evidence too~~ concluded there was insufficient ~~to be taken forward as formal projects leading to including provisions in the code, or evidence~~ for the Board to yet have a formal position on ~~them. MFR or tendering on a “comply or explain basis”~~. Mr. Dakdduk noted that these minutes would be a public record of the Board's discussions so far on these matters. ~~It has not yet been possible to discuss non-audit services because of a lack of resources.~~ However, the Board agreed to devote some resource to further research and monitoring developments, including the U.K. experience with tendering, the Canadian review, and the wider issues considered in the discussion. Mr. Dakdduk said that the Board wishes to explore what more can be done to promote greater skepticism and independence.

The Board agreed that it would develop a formal project proposal to review the partner rotation provisions in the code, in terms of maximum periods on the audit, minimum periods off, what partners might do while off the audit and the scope of who is covered by the rotation requirements.

## 5. Those Charged with Governance

Ms. Munro introduced the topic noting that at its February 2012 meeting, the IESBA discussed responses to the Breaches exposure draft. A respondent noted that the Code definition of “those charged with governance” is not completely consistent with the definition contained in ISA 260 “Communication with Those Charged with Governance” and that the ISA recognised communication with a sub-group thereof. At its February meeting, the IESBA considered ISA 260 and concluded that the communications required under the Code should be to the same group of people as the communications under ISA 260. The IESBA, therefore, had agreed that a project should be undertaken to align the Code definition of those charged with governance more closely with the definition contained in the ISA.

The Board discussed and approved the proposed project proposal. The proposal had been circulated, as required, to the other PIACs and IFAC committees. Given the relatively narrow scope of the project, and in anticipation of such approval, the Breaches Task Force had already considered the matters under review and the meeting moved to discuss the Task Force’s proposals.

The Task Force had considered ISA 260 and has developed language to conform more closely to the ISA. ISA 260 deals with the auditor’s responsibility to communicate with those charged with governance. It addresses matters to be communicated and provides guidance on who should receive the communication. The Task Force has proposed the following definition:

*Those charged with governance*

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

It was noted that this definition is the same as in the ISA except that it does not contain a final sentence which is relevant only in the context of ISA application. It was noted that the definition could include senior “staff” in the organisation.

The Board discussed and agreed to this definition.

To recognise that in applying provisions in the Code it may be appropriate for the professional accountant to communicate with a subgroup (whether an individual or a sub-committee such as the audit committee) the Task Force proposed to include the following explanatory paragraph in Section 290:

*290.29 In complying with requirements in this section to communicate with those charged with governance, the firm shall determine the appropriate person(s) within the entity’s governance structure with whom to communicate. If the firm communicates with a subgroup of those charged with governance, for example an audit committee, or an individual, the firm shall determine whether communication with all of those charged with governance is also necessary so that they are adequately informed.*

The Board discussed and agreed to this new proposed paragraph.

The Board then discussed application of this in the Section. Options considered were:

- Having an explanatory sentence up-front stating that a reference to “those charged with governance” should be interpreted in accordance with 290.29, or
- Repeating each time there is a reference to “those charged with governance” that consultation could take place with a “subgroup”, for example *“Where a matter involves a conflict with, or within, an organization, a professional accountant shall determine whether to consult with those charged with governance of the organization or a subgroup thereof such as the board of directors or the audit committee”*.

Individual board members expressed preferences but on balance it was decided that the Exposure Draft should proceed with the second option outlined above, as generally more helpful to the reader. It would also help the reader to evaluate whether consultation with a subgroup was felt appropriate in the context of the specific provision.

The Exposure Draft will include only those paragraphs that are effected, but the complete code will be presented on the web-site with the amended paragraphs should a reader wish to review the changes in situ.

The IESBA unanimously approved the exposure draft.

An Exposure Draft will be prepared on the basis of the above, and was approved unanimously in principle. The Exposure Draft will be provided to Board members. It will also be provided to members of the CAG to ensure that they accord therewith.

An effective date of one year after final adoption will be proposed to allow member bodies to reflect the changes in local Codes.

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

Ms. Orbea introduced the topic and reported on the activities of the Task Force since the February 2012 meeting.

At the February 2012 meeting in Dublin, the board agreed that the Code should contain provisions to address breaches and that all breaches should be reported to maintain transparency and reduce subjectivity. However the board believed that flexibility of timing for reporting should be considered for less significant breaches. The Task Force was also directed to consider other issues and drafting of provisions as described below.

### *General Provisions*

Paragraph 100.10 addresses a breach of a provision of the Code that does not relate to independence. The Task Force was asked by the Board to consider enhancing the wording to provide a clearer thought process to be followed. The Task Force recommended splitting paragraph 100.10 into two parts. The first paragraph provides the reference to Sections 290 and 291. The second paragraph requires evaluation of the significance of the breach and the impact on compliance with fundamental principles.

### *Communicating Breaches and Timing*

There is agreement that all breaches should be reported. However, some flexibility may be appropriate for less significant breaches. The Task Force was asked by the Board to consider whether timing and protocol for less significant breaches could be agreed with those charged with governance. The Task Force also discussed what communication to those charged with governance should be in writing.

A survey with five questions was developed and posted on the IESBA website. As of 19 June 2012, 517 responses were received. The majority of the respondents agreed that all breaches should be reported (88%). Regarding timing of reporting, 67% of the respondents agree with some form of flexibility and 51% of the respondents considered that the form of communication should be verbal, as soon as possible and followed by written communication.

The Task Force recommended amending paragraphs 290.46 and 290.47. The requirement that all breaches are to be discussed as soon as possible was retained. However the Task Force proposed changes to paragraph 290.46 so that timing for less significant breaches can be agreed with those charged with governance. The Task Force also proposed changes to paragraph 290.47 to require communication in writing after discussion with those charged with governance has occurred so that concurrence can be obtained. Other minor wording changes to paragraph 290.46 and 290.47 were agreed to assist the flow of the proposed steps and to remove ambiguity.

It was noted that a member of the CAG had said that all breaches should always be reported as soon as possible, and ~~therefore it was suggested~~recommended there should be a requirement that such breaches be communicated verbally to the chair of those charged with governance. Ms. Orbea noted that the responses from the survey indicated that such communication should take place unless there is different agreement with those charge from governance.

It was noted that the requirement in paragraph 290.47 to provide a description of the firm's relevant policies and procedures was very broad and it was agreed that the Task Force would consider clarifying that only those policies and procedures that are relevant to the breach should be communicated.

### *Reporting to a regulator*

The Board concluded in Dublin that it is not appropriate for the Code to require reporting of breaches to a regulator. However the Task Force acknowledged instances where reporting is encouraged or ~~a~~ best practice in a jurisdiction and recommended additional wording to this effect.

Mr. Wymeersch commented that the exposure draft does not include any reference to reporting to authorities except for a "may" requirement which is not an objective requirement, and said that if the breach is serious, the Code should contain an objective requirement to report.

The Board discussed whether the provisions should include a requirement or an expectation to report. It was noted that in many jurisdictions, there is no regulation of audits for non-PIEs and professional rules are applicable which may not include such requirements. It was also noted

that three of the regulators who responded to the exposure draft did not request a requirement to report, but expressed an expectation to report where such reporting is required or common practice. The Task Force was asked to consider revising paragraph 290.41 to reflect an expectation of [the need to consider](#) reporting where it is either required or encouraged in the particular jurisdiction.

The Board considered expanding paragraph 290.49 by adding a requirement to document the rationale when the firm decides not to report a regulator. It was suggested to improve the wording used in this paragraph by requiring that the firm document all key decisions and the rationale behind them.

#### *Significance of the breach*

One respondent (IOSCO) noted that the last factor in paragraph 290.42 was incomplete as independence impairing non-assurance services may not necessarily have an impact on the financial statements. The Task Force proposes amending paragraph 290.42 and to make the statement more general regarding the impact on financial statements. [After debate, a further amendment was agreed to improve clarity of the point.](#)

#### *Agreement of those charged with governance*

The Task Force was asked by the Board to look at the wording to avoid the suggestion that the audit activity must be suspended until agreement from those charged with governance is obtained, or that responsibility is being devolved to those charged with governance. The Task Force therefore proposes the following amendments to paragraph 290.47: the sentence “may continue with the audit engagement” will be deleted to remove the perception that the audit activity must be suspended unless those charged with governance agree with the proposed actions, and “agreement” is changed to “concurrence”.

#### *Effective date*

24 respondents agreed with proposed effective date of approximately 6 months after approval. 11 respondents felt a longer period is necessary to allow translation, training and systems enhancements. Therefore the Task Force recommended and the Board agreed with an effective date of 1 January 2014, or approximately 12 months after release.

#### *Other items*

Mr Uzuka commented that 2/3 of the respondents to the survey are located in North America. Only a small number of respondents are from Asia and therefore the responses may not be representative of international views. Ms Munro noted that the responses from North America came in later than the other responses and that the results did not change significantly at that point. The survey will remain open till the final vote on the exposure draft and Board members were encouraged to keep soliciting responses in their jurisdictions or regions.

[The final redrafting was not undertaken at the meeting but was to be made available to the Board before finalization and before being provided to the CAG in final form. The Board voted unanimously in favour of the document, pending these final amendments in line with the above discussion. It was expected that the final amendment to the Code would take place before the end of the calendar year.](#)

## 7. Reformatting of the Code

Mr. Dakdduk introduced the topic.

He reminded the Board that at its meeting in February 2012, the IESBA agreed to consider how the structure of the Code could be improved to raise the visibility of its requirements and prohibitions and, with respect to the independence requirements in the Code, how to better explain who within a firm has the responsibility for complying with them. He stated that subsequent to that meeting, the Planning Committee met and has prepared an example of a revised structure using the provisions in Section 290.102 to 290.231 that apply to audit clients that are not public interest entities. Mr. Dakdduk explained that the example repositions the requirements and prohibitions in each section and places them at or near the beginning of the paragraphs that discuss the requirement or prohibition. He noted that the requirements and prohibitions have been presented in bold to make them more obvious and easier to identify. In addition, certain paragraphs that have been highlighted represent areas that could possibly be deleted. Mr. Dakdduk commented that this represents one example of a reformatted Code but that there could be other approaches as well for the Board to consider. In considering the proposed reformatting, he asked the Board to be mindful of member bodies and others who adopted the Code and consider any issues it might create for them. Mr. Dakdduk then asked the Board members for their reaction, specifically as to whether the proposed reformatting was viewed as an improvement or if it could be viewed as if the IESBA Code has moved further from a principles-based Code to a rules-based Code.

Overall, Board members were supportive of the reformatted text and agreed any steps to make the Code better understood by its users would be beneficial. Certain members noted that additional clarity steps should be considered as well such as clarifying certain provisions that are long-winded and insertion of additional subheadings, for example, in the financial interests section. Another member suggested that the Code could possibly break down the guidance to make it specifically applicable to professional accountants in public practice, business, public sector, etc.

One Board member ~~expressed some hesitation of returning to the~~ commented on a “black vs. gray letter” format ~~and questioned why IFAC moved from that format which was in existence years ago~~. Mr. Dakdduk explained that ~~in the past~~, there was some concern and risk that users would only read the bold text and ignore the remainder. However, in today’s environment and given the length of the Code, users appear to prefer a Code where specific prohibitions and requirements could be easily identified.

Mr. Wymeersch noted that the Board may wish to consider existing Codes used in corporate governance, such as those in the United Kingdom and Germany, where the technique is to begin with principles that are developed into procedures, explanations and examples. He also noted that cross references could be used in place of repetition in the Code.

One Board member recommended that the Board obtain input from those who have implemented the Code on whether this approach would be useful and that the Board should also consider the costs and benefits for member bodies that are in the process of implementing the extant Code. Mr. Dakdduk agreed that it was important to determine that member bodies would support such a



project ~~and noted that it is not intended for this project to commence immediately but rather, it would likely be deferred to 2014-2015.~~ Mr. Dakdduk then invited Mr. Hannaford, Mr. Bromell and Ms. Snyder to provide input on how such reformatting could impact their convergence efforts and adoption of the IESBA Code.

Mr. Hannaford noted the proposed approach is closer to that followed by the profession in Canada. In Canada the Rules of Professional Conduct include the specific requirements and prohibitions on ethical matters affecting all Chartered Accountants. In addition, any guidance that is provided is included separately in what is commonly referred to as Council Interpretations of the Rules.

The Rules and Council Interpretations are structured this way in order to enhance enforceability. Members can be charged with professional misconduct if they do not comply with the Rules of Professional Conduct but would not be charged for misconduct based on non-compliance with the guidance included in the Council Interpretations.

In Canada, the Rules are adopted on a province-by-province basis rather than on a national basis since the regulation of the profession is a provincial responsibility by legislation in Canada. In order to achieve consistency across the country, a committee is established that recommends changes to the rules so that they may be harmonized across all jurisdictions. Canada is a bilingual country and all rules must be presented in both English and French.

Mr. Hannaford noted that the proposed reformatting exercise draws a lot of parallels to the approach that is followed in Canada with respect to accounting and auditing standards. The requirements or prohibitions are included together with the guidance but the requirements are separately identified by italicized wording rather than bold lettering. He indicated that this should be familiar to professional accountants in Canada and may be found to be a more acceptable format than the existing Code where the requirements and prohibitions are not clearly laid out.

He indicated that it may be better if the requirements were consistently included at the beginning of each section rather than interspersed throughout the Code. He said he would be prepared to review the proposed format with others in the profession in Canada to see if this approach would be considered more user-friendly. He would also want to discuss with legal counsel to ensure that the enforceability concerns were allayed.

Mr. Bromell explained that the ICAEW Code has had a “threats and safeguards” approach for many years and in 2005 adopted the IESBA Code in its entirety with minor amendments for UK legislation and added some additional sections for UK legislation such as corporate finance, insolvency, and referrals. UK legislation requires listed companies to comply with Auditing Practices Board standards on independence. He noted that there are always certain issues when revising the Code because of due process requirements but overall, he believed a move of this nature would not be a dramatic change and could be achieved. It was noted that the ICAEW membership approve changes and it is necessary to demonstrate any impact of the change to them.

Ms. Snyder provided the Board with a description of the AICPA Code and explained that while the wording of the AICPA Code may differ from that of the IESBA Code, in substance, the requirements and prohibitions are largely the same. She noted that the AICPA Code had high level specific rules which are comparable to the IAASB principles, and has interpretations which use different language to that used in the Code. She noted that the AICPA is in the final stages of codifying the AICPA Code in a similar structure to IESBA with one section for Professional Accountants in Practice, one for Professional Accountants in Business and one for others. As part of this project, the Code will incorporate specific threats and safeguards associated with each of the requirements. Accordingly, she expressed some concern that if the Board decided to delete all the highlighted text in the draft document, this could pose an issue since it would remove the context of why certain relationships are prohibited. Ms. Snyder added that she did not believe the reformatting of the content itself would pose an issue since the AICPA Code does not adopt the IESBA Code verbatim and the AICPA's language differs in many areas even though in substance the Codes are the same. She noted, however, that incorporating bold text could be a problem due to consistency issues with other AICPA professional standards. It was noted that in the USA it is necessary to recognize that individual states decide whether to recognize the Code, and that SEC and PCAOB rules apply to listed entities.

Based on the input received, Mr. Dakdduk commented that it appears the Board would support exploring a reformatted Code and given its limited resources, asked Ms. Munro to comment on how the Board could best ensure that its stakeholders would support such a project. Ms. Munro discussed the process implemented by the IAASB to obtain stakeholder input, which included a forum to obtain input on its clarity project. Mr. Dakdduk recommended that the Board consider a forum and other outreach opportunities such as an electronic survey and discussions with the CAG, PIOB, and Monitoring Group to get feedback on the idea of a reformatted Code. He also recommended that the Board develop an action plan to ensure support of key stakeholders. The IESBA agreed that the Planning Committee should consider the input received from Board members and determine whether a major complete reformatting exercise should be done now or possibly smaller steps taken to improve the Code with additional steps taken at a later date. It was agreed that the Planning Committee would take this project under consideration and report its recommendations to the Board at its next meeting.

## **8. Review of Part C of the Code**

Mr. Gaa introduced the topic.

He reported on the activities of the Part C Working Group and explained that to ensure the working group had broad input, Ian Rushby, a member of the PAIB Committee with large corporate experience and Larry Kean, Secretary & Treasurer, A&A Manufacturing Co. and a member of the IESBA SME/SMP Working Group were invited to join the Working Group.

Mr. Gaa explained that the Working Group researched and reviewed major accounting irregularities that had been publicized around the world. He stated that the review of the major accounting regularities, however, appear to focus on illegal acts rather than acts of an unethical nature as well as the role of the auditor. Accordingly, they were not deemed to be very helpful.

Mr. Gaa also explained that the Working Group surveyed certain IFAC member bodies that have a large number of professional accountants in business (PAIBs) as members in order to determine what issues and problems they encounter in dealing with PAIBs. The results of the survey indicated that the number of ethical queries received by member bodies from PAIBs is insignificant compared with those from practitioners. The only significant common issue noted by PAIBs was being pressured by those charged with governance or supervisors to report misleading information.

Mr. Gaa reported that the Working Group identified a number of major issues that it recommends the Board consider with regard to enhancing Part C of the Code. First, the Working Group believes additional guidance is needed for PAIBs when preparing and reporting faithful representations of economic phenomena and further discussion on the negative responsibility not to be associated with misleading information and reports. In connection with this issue, the Working Group recommends that the Code could provide guidance on the meaning of “improper earnings management” and when earnings management becomes improper. Mr. Gaa explained that the second issue is the pressure on PAIBs from superiors to violate legal or ethical standards. Accordingly, the Working Group recommends that the Code include guidance on how PAIBs should deal with pressure from superiors to engage in unethical or illegal activity as well as guidance for PAIBs who may pressure subordinates.

Mr. Gaa noted that other possible issues identified by the Working Group that could be addressed in Part C include expanding the guidance dealing with “receipts and offers of items of value” since this is an important issue for PAIBs operating across jurisdictional boundaries and guidance on whistleblowing. He noted that the Working Group also believes that it is necessary to enhance the awareness of the Code by PAIBs.

Mr. Gaa requested feedback from the Board on the various recommendations proposed by the Working Group. A number of Board members expressed support for the recommendations proposed by the Working Group and believed the document prepared by the Working Group reflected a good understanding of the practicalities and realities of issues faced by PAIBs. Certain members, however, believed that the project should be expanded to revise the entire Part C rather than just specified areas within Part C. One member suggested that Part C should also provide guidance on “financial management” issues, such as decision making in financial support roles (e.g., where finance personnel construct decisions in such a way as to justify the decisions of senior management).

Some members expressed caution with respect to addressing the issue of “earnings management,” specifically as to when earnings management would be considered improper or unethical if the reporting of the transaction is not illegal nor contrary to GAAP. It was further noted that the Working Group should be careful not to develop a framework that would be inconsistent with that of the IASB. Overall, the Board was supportive of developing guidance addressing the behavior of the PAIB when faced with improper earnings management but believed that such guidance should not address whether specific types of earnings management would be considered improper.

Mr. Gaa asked the Board whether there were any other issues that should be considered by the Working Group. One Board member recommended that Part C should include guidance specific to professional accountants in government. It was noted that while the pressures facing such accountants are probably similar to other PAIBs, the remedies available could be different. It was noted that the Working Group may also wish to seek the views of the International Organisation of Supreme Audit Institutions (INTOSAI) in this regard. Another member recommended that additional guidance should be included to address how PAIBs could ethically use the skills and experience gained when changing employment without disclosing confidential information of the prior employer as well as guidance on accepting employment with a new employer. Other possible issues noted by Board members included dealing with aggressive valuation estimates and alternative accounting treatments, especially when such accounting treatments could impact the PAIB's bonus or other compensation.

It was recommended that the Working Group conduct further outreach with PAIBs and other stakeholders to determine what additional guidance should be addressed in Part C. Mr. Dakdduk thanked the Working Group for their report and stated the Board would receive a final recommendation from the Working Group with prioritization of the various issues at its December meeting.

## 9. Remarks from the PIOB

Mr. Dakdduk invited Mr. Wymeersch to make his closing remarks on the three day meeting which he had observed. Mr. Wymeersch made the following remarks:

It had been a very good meeting and he appreciated the manner of the discussions. He thought the discussion of the [proposals relating to Reporting Suspected Illegal Acts](#) ~~discussion~~ was excellent, and that he expected this project will receive attention from outside the profession. He said he was very satisfied.

The discussion on rotation had been very good and very helpful. It was unfortunate that the matter was being addressed too late for regulators to benefit from listening to the good arguments presented at this meeting. He recognized that these matters can be ~~influences~~[influenced](#) by political considerations and it is difficult to eliminate politics from a consideration of this subject.

On the Breaches project he encouraged the Board to consider a way to distinguish between important and unimportant breaches.

He noted that the Code can be a difficult document to understand. Reformatting of the Code is a welcome exercise and he commended those who had added this matter to the agenda. He hoped bold action will be adopted, including simplification, transparency and clarity, and a recognition of the needs of small firms.

He said he would not repeat his concern regarding the length of IESBA's due process. He suggested providing a signal to the markets that something is forthcoming on [responding to suspected](#) illegal acts and noted that the ED would do this. This would forewarn stakeholders of these matters before ~~they are in force~~[the Board concludes its deliberations next year](#).

He noted that implementation of the Code is an important matter. He commended the work of IFAC on the SMOs, on adoption and implementation at local level and said it would be helpful if IESBA could feed into these discussions.

Finally he thanked Mr. Dakdduk on behalf of the PIOB for his excellent chairing. Mr. Dakdduk has shown great expertise in encouraging a free and open debate, at teasing out the debate, providing a good synthesis and driving the debate forward. The Board is functioning better than when Mr. Dakdduk became chair and it is well positioned to continue into the future. Mr. Wymeersch led a round of spontaneous applause for Mr. Dakdduk from the Board.

Mr. Dakdduk said he felt he was leaving the Board with unfinished business but that with a new leadership it was entering a positive new chapter and making great strides that are responsive to the needs of stakeholders. He said he would follow its work closely. He recognized the quality of the work of Board members and their technical advisers. He said he wanted his legacy to be that he left the Board in a better place than when he started and that that had been achieved and he hoped all successive chairs would also be able to say the same thing. He thanked and acknowledged:

- The members of the Board for their support and challenge in working to a common purpose.
- Technical Advisers, especially Ms. Snyder, for supporting their Board members.
- Mr. Fleck the Chair of the CAG for his council and because of the importance of the CAG to IESBA. He noted how effective the CAG has become since Mr. Fleck became chair.
- Mr. Walsh for his advice as deputy chair.
- The PIOB, and particularly Mr. Wymeersch as chair of the PIOB, for diligently attending IESBA meetings.
- The Japanese FSA, including Mr. Uzuka and his predecessor for the benefit of having a regulator in the meetings.
- All the staff of IESBA.

Mr. Fleck responded on behalf the IESBA. He said that it has been a great personal privilege to work with Mr. Dakdduk. He congratulated Mr. Dakdduk for leading the Board in addressing challenging issues, in developing the outreach of the Board and improving relations with important stakeholders, for the style of his leadership, his thoroughness, his unfailingly courtesy, his openness to dissenting views, and for always seeking consensus. In conclusion, Mr. Dakdduk has left the Board better than when he started.

Mr. Dakdduk thanked the IESBA and closed the meeting. Dakdduk also thanked Ms. Munro. Her ability to think quickly and unconventionally and to resolve issues greatly benefited the board. He said he especially appreciated her advice and counsel.

Mr. Dakdduk thanked the IESBA and closed the meeting.

**Separate Attachment: Ethics Workshop Feedback Paper (PDF)**