

Report Back on September 2012 CAG Representatives' Comments

CAG Representatives' Comments	Task Force Response
<p>Mr. Baumann asked whether the use of professional judgment could lead to a conflict not being disclosed</p>	<p>Professional judgment is required to be used when identifying and evaluating interests and relationships that might create a conflict of interest and when implementing safeguards. This may lead to circumstances in which an accountant determines that a conflict need not be disclosed. The Task Force has developed a revised proposal ("revised proposal") which clarifies that disclosure and consent may take several different forms. The revised proposal also introduces a requirement for the professional accountant to determine whether the significance of the conflict is such that specific disclosure and explicit consent are necessary. Specific disclosure includes the circumstances of the particular conflict together with any planned safeguards, sufficient to enable the client to make an informed decision with respect to the matter and to provide explicit consent accordingly. The revised proposal encourages the professional accountant to document disclosure whenever made orally otherwise written disclosure itself provides evidence of the professional judgments involved.</p> <p>Whilst the revised proposal does not define a bright line for when a conflict has to be disclosed, it does provide specific conditions that have to be met before an accountant can accept an instruction when specific disclosure cannot be made solely because this would breach confidentiality. The revised proposal requires the professional accountant to document the application of these provisions and the reason why it is appropriate to accept the engagement in these circumstances.</p>
<p>Mr. Morris asked how the professional accountant should respond when told about a conflict that s/he had not previously identified. Because there is no definition of a conflict of interest, there should be guidance on how the professional accountant should act. Mr. Fleck agreed that it would be unacceptable for a professional accountant to ignore such a matter and asked the Task Force to consider the matter.</p>	<p>The task force intends that the reference in paragraph 220.1 to being "faced with a conflict of interest" would extend to a conflict or potential conflict that has been brought to the attention of the professional accountant by others. The revised proposal requires that the professional accountant "shall remain alert to such changes (in the nature of the services and relevant relationships) for the purpose of identifying circumstances that might create a conflict of interest". The task force has also added a sentence in paragraph 220 referring to the conflict identification process extending to matters notified by external parties, for example clients or potential clients.</p> <p>Paragraph 220.7 refers to the need for "an effective</p>

	<p>conflict identification process”.</p> <p>Paragraph 220.3 requires the professional accountant to apply the third party test during the identification process. Professional accountants will use a variety of methods to identify potential conflicts and this will clearly extend to considering reports received from other parties, including a prospective or existing client.</p> <p>Taken together these provisions require that the professional accountant take account of a conflict or potential conflict of interest if notified by others.</p>
<p><i>Conflicts of Interest and Independence</i></p> <p>Ms. De Beer referred to direct reporting engagements under ISA 3000 whereby the assurance provider is responsible both for evaluating the subject matter of the engagement and for giving an opinion. The IAASB had considered whether a conflict could exist in this situation. She asked whether the description of a conflict of interest would cover this situation.</p> <p>Ms. De Beer said that threats to independence and threats to objectivity are subtly different, and the difference may be missing from the exposure draft.</p> <p>Ms. De Beer gave the example of a firm being asked to prepare a sustainability report when another part of the network has set up the systems, and said that the reason to believe test is a test of the network’s processes. Ms. De Beer said that a cross reference is needed.</p>	<p>Paragraph 291.20 (Direct Reporting Engagements) requires that the firm be independent of the assurance client and evaluate any threats the firm has reason to believe are created by network firm interests.</p> <p>The accountant is only required to be independent when providing audit, review and other assurance engagements. Section 280 describes requirements for objectivity for all services provided by professional accountants in practice. Independence is necessary for the professional accountant to express a conclusion without a conflict of interest (280.2).</p> <p>The Task Force has considered the relationship between independence, objectivity and conflicts of interest. A reference to the need to comply with Sections 290 and 291 when performing an audit or other assurance engagement has been included in the revised proposal. Further, an example of an assurance engagement, which recognizes that such an engagement can be a professional service involving a conflict of interest, has been added to Paragraph 220.2.</p>
<p>Mr. Hansen said that conflicts are often about relationships between parties and the conflict is broader than a situation where the subject matter of the accountant’s professional service relates to the subject to the conflict between the parties.</p>	<p>In order for a professional conflict to be created there needs to be a linkage between the service and the particular matter on which the parties’ interests conflict and the greater the linkage the greater the conflict. Consequently the Task Force is of the view that a relationship alone is insufficient to result in a conflict of interest.</p> <p>In particular, having two audit clients who have some conflicting or competing interest between them does not create a professional conflict for the auditor if it does not provide professional services in</p>

	<p>relation to the conflicting or competing interest. The task force has attempted to bring out this principle in the examples, for example the second example addresses a situation where clients' interests compete with respect to the professional services.</p> <p>The revised proposal does however recognize that relationships might create a conflict of interest when identifying and evaluating a potential conflict.</p>
<p>Mr. Hansen said that the auditor possessing knowledge could create a conflict of interest because it could be detrimental to one client if that knowledge is disclosed to the other client.</p> <p>Mr. Fleck said that it is important to distinguish between professional, commercial and legal relationships. In the UK, a professional accountant could not act for one party if they hold relevant information derived in confidence from another client and could not safeguard confidentiality if they accept the engagement. He asked the Task Force to consider how this issue is reflected in the proposal.</p>	<p>Section 220 is addressing professional conflicts and not, in particular, commercial conflicts that a professional accountant might face. Confidentiality issues are specifically addressed in the confidentiality section of the Code (Section 140). However, the revised proposal emphasizes the need to remain alert to the fundamental principle of confidentiality.</p> <p>Further, in the revised proposal, the guidance for the situation when making specific disclosure would result in a breach of confidentiality has been strengthened, including the conditions that have to be met before an engagement can be accepted in these circumstances.</p>
<p><i>Reason to believe test:</i></p> <p>Mr. Baumann asked how the reason to believe test in Section 220 compares with the network tests in the Independence sections 290 and 291. He asked if more should be done to distinguish between conflicts of interest and independence.</p> <p>Mr. James asked whether there should be different tests for auditors and assurance providers.</p> <p>Ms. De Beer, supported by Mr. Hansen and Mr. Baumann, asked why the reason to believe test in conflicts of interest is weaker than that used in Section 290.</p> <p>Mr. Morris said that there is an interaction between Sections 220 and 290 which is complex and difficult to understand. He said that 290 should over-ride 220 and suggested that the solution could be a cross reference.</p> <p>Mr. Fleck noted a sense amongst CAG representatives that it is not clear enough that the reason to believe threshold, as drafted, is sufficiently strong to demonstrate that accountants are acting in the public interest. He suggested that the IESBA may wish to consider these matters.</p>	<p>Section 290 applies to interests and relationships between the firm (including, its network firms) and its audit or review client that might affect the independence of the firm in performing the audit or review. The scope of section 291 is equivalent to section 290 but with respect to assurance engagements other than audit and review. (In the case of section 291 the restrictions apply beyond the firm performing the engagement to network firms only when the firm performing the engagement has reason to believe that interests and relationships of network firms are relevant to evaluating the independence of the performing firm.) Section 220, however, applies more broadly to <i>any</i> interests and relationships that might represent a conflict of interest when performing any service for any client of a professional accountant in public practice (for example, relationships with other parties who have a conflicting interest with the client), i.e., not limited to interests and relationships with the audit/assurance client itself. Therefore the scope of section 220 on the one hand and sections 290 and 291 on the other are not comparable.</p> <p>In order to avoid any uncertainty, however, a cross reference to sections 290 and 291 has been added in 220 to clarify that those sections also apply when evaluating independence for the purposes of audit and other assurance engagements.</p>

	<p>In the revised proposal, paragraph 220.7 has been modified, as proposed by certain respondents, to strengthen the reason to believe test as follows:</p> <ul style="list-style-type: none"> • linking it more clearly to the identification process for networks; • adding “knows” to “has reason to believe”; and • adding “having made enquiries as appropriate”.
Mr. Koktvedgaard asked if cases exist where the professional accountant does not need to be independent.	Independence is only required for audit and assurance engagements.
Mr. Koktvedgaard asked what systems should be in place to identify conflicts and said that the reason to believe test is too weak.	<p>The revised proposal provides guidance on the elements of an effective conflict identification system. The Task Force does not, however, consider it appropriate for the Code to impose specific requirements for conflict identification systems across a network, regardless of the scale or form of the network. This view reflects in particular the fact that networks take many different forms, ranging from small, relatively loose structures with limited sharing of information to large multi-national structures with common policies and processes across the entire network.</p> <p>In the revised proposal, paragraph 220.7 has been modified, as proposed by certain respondents, to strengthen the reason to believe test as follows:</p> <ul style="list-style-type: none"> • linking it more clearly to the identification process for networks; • adding “knows” to “has reason to believe”; and • adding “having made enquiries as appropriate”.
Mr. James asked whether an analysis had been prepared of responses by category of respondent.	The IESBA June agenda paper 3 contains an analysis of responses by category of respondent for each question.
<p><i>Public Interest</i></p> <p>Mr. Kuramochi provided an example to illustrate IOSCO’s comment that the proposal did not adequately address the public interest. He illustrated his point by using an example whereby the auditor of Company A becomes aware during the audit of a suspected fraud in Company A and wishes to reach out to an external party, Company B, to gather further evidence about the matter. Mr. Kuramochi indicated that in this case, because the auditor is paid by Company A, Company A would be able to pressure the auditor not to contact Company B to obtain the necessary information and as a result, there would be a risk that the auditor would place Company A’s interests ahead</p>	<p>At its June meeting, Mr. Dakdduk noted in response to this comment 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.</p> <p>The IESBA is of the view that IOSCO’s comment falls outside the remit of the Conflicts of Interest project because it raises issues that apply to the Code generally.</p>

<p>of the public interest. Mr. Fleck was of the view that in this case, it would be more of a limitation of scope that would be addressed by auditing standards.</p> <p>Mr. Hansen supported IOSCO's response that public interest is a fundamental principle. He said that there were situations when it was necessary to decline an engagement and that 220.10 should be given greater prominence, perhaps towards the beginning of the Section.</p> <p>Mr. Ratnayake supported the suggestion that the Public Interest should be a fundamental principle.</p>	<p>The paragraph (now 220.5) recognizing that it may be necessary to decline or discontinue an engagement has been moved to earlier in the Section to increase its prominence.</p>
<p><i>Third party test</i></p> <p>Mr. Bluhm noted that the third party test applies in identifying and evaluating a conflict of interest and implementing safeguards. He suggested that the third party test be repeated in 220.5 and 220.6 in case the paragraphs are read in isolation. He also suggested that 220.7 and 220.10 should be linked as both relate to safeguards.</p>	<p>Change not made to avoid repetition.</p> <p>However the Task Force noted that a number of respondents have stated that the third party test is subjective and requested further guidance on it.</p> <p>The Task Force has alerted the Planning Committee to these requests because the issue has implications for the Code in general.</p>
<p><i>Documentation</i></p> <p>Mr. Koltvedgaard asked how the documentation requirements apply.</p> <p>Mr. James said that the accountant should document the safeguards that are applied in 220.7.</p> <p>Mr. Thorpe said that what a third party test would conclude is unclear, therefore clear disclosure of conflicts to the client and sufficient documentation is necessary.</p> <p>Mr. Koltvedgaard endorsed the views of Mr. James and Mr. Thorpe, and Mr. Baumann said that the CAG members had given a strong sentiment.</p>	<p>The Task Force has considered the documentation requirements, and is of the view that documentation is a decision for the professional accountant that does not change the facts as to whether the existence of a conflict of interest compromises the professional accountant's objectivity or compliance with the other fundamental principles.</p> <p>The revised proposal, however, requires the professional accountant to determine whether the significance of the conflict is such that specific disclosure and explicit consent is necessary. Where such disclosure is made, the disclosure of the circumstances of the particular conflict together with any planned safeguards, together with the client's written consent (or otherwise), provides documentation of the matter. The revised proposal encourages documentation when disclosure is verbal or consent is verbal or implied. The Task Force does not believe that it is appropriate for the Code to mandate documentation for the reasons stated above.</p>