

**Meeting:** IESBA  
**Meeting Location:** New York  
**Meeting Date:** December 10-12, 2012

## Agenda Item

# 2

### Breach of a Provision of the Code

#### Objective of Agenda Item

1. To consider proposed changes to the exposure draft wording to address IESBA comments, and approve the final standard.

#### Task Force

2. Members:
  - Kate Spargo, Chair, IESBA Member
  - Wui San Kwok, IESBA Member
  - Alice McCleary, IESBA Member
  - Marisa Orbea, IESBA Member

#### Background to the Project

3. On October 15, 2012, the IESBA met via conference call to approve proposed changes to the Code to address a breach of a provision of the Code. The IESBA discussed the proposed changes but did not approve the document. The IESBA asked the Task Force to consider six specific matters, three of which related to specific drafting suggestions and three of which related to issues raised by IOSCO. The IESBA agreed that, subject to any changes to address these matters, the IESBA would support issuing the document in final form.
4. The Task Force met by conference call on November 19, 2012 to consider the matters identified by the IESBA.

#### Discussion

##### *Specific Drafting Suggestions*

5. ¶290.42 – Two comments were raised regarding this paragraph. It was noted that the first sentence was awkwardly worded. It was also noted that the proposed second sentence seems to establish a requirement that responsibility for independence be assigned to an individual and ISQC1 does not contain such a requirement.
6. The Task Force has considered the two sentences and proposes the following changes to smooth the drafting and also to eliminate the suggestion that the responsibility for independence be assigned to an individual:

When a breach is identified, the ~~firm shall be notified in accordance with its policies and procedures to enable it to take appropriate actions to address the consequences of the breach. The~~ breach shall be promptly communicated to the engagement partner, in accordance with the firm's policies and procedures, the individual assigned those with responsibility for the policies and procedures relating to independence, and other relevant personnel in the firm, and, where appropriate, the network, and those subject to the independence requirements who need to take appropriate action.

7. ¶291.35 addresses the timing of the communication of a breach in an assurance engagement that is not an audit or review engagement which was the same as for an audit or review engagement – namely as soon as possible unless the engaging party or those charged with governance had specified an alternative timing for the reporting of less significant breaches. It was noted while there would be a formal process for establishing timing of communication with those charged with governance with respect to audit or review clients, the same process might not be in place for other assurance clients. The IESBA, therefore, asked the Task Force to consider whether the timing of reporting should be the same as for audit and review clients.
8. The Task Force has considered the matter and also notes that the nature of other assurance engagements can vary significantly. Other assurance engagements might be recurring or “one-off” in nature; the number of users might also vary significantly. The Task Force, therefore, recommends that the timing of reporting of a breach should be more situational in nature and proposes the following changes:

If the firm determines that action can be taken to satisfactorily address the consequences of the breach, the firm shall discuss the breach and the action it has taken or proposes to take with the party that engaged the firm or those charged with governance. The appropriate timing for communicating the breach will vary with the circumstances of the engagement and the breach. The firm shall discuss the breach and the proposed action as soon as possible, unless the party that engaged the firm or those charged with governance have specified an alternative timing for reporting less significant breaches.

9. Other editorial changes – Agenda Paper 2-A reflects the minor editorial changes as agreed on the October conference call.

#### **Matter for IESBA Consideration**

The IESBA is asked consider the proposed changes.

#### *Outstanding Issues Raised by IOSCO*

10. On the October Board conference call, Ms. Spargo reported on a conference call held with some IOSCO representatives. The IESBA discussed comments from IOSCO (see draft minutes in Agenda Paper 1-A) and asked the Task Force to give further consideration to three specific matters.

#### Those Charged with Governance

11. It was noted on the IOSCO conference call that those charged with governance play an important role in the proposals. They receive the communication of any breaches and concur that the action taken (or to be taken) satisfactorily addresses the consequences of the breach. It was noted that those charged with governance may have an interest in finding a solution (so as to avoid a change

in auditor) and in some jurisdictions, those charged with governance might not be as strong as in other jurisdictions.

12. The Task Force has considered this matter and is of the view that no changes are necessary to the proposals. In many jurisdictions, those charged with governance have legal responsibilities regarding the need for an independent audit. The Task Force also notes that the extensive documentation requirements provide an appropriate level of transparency by providing an audit trail of any identified breaches and actions taken to address such breaches, if any.

#### Additional Guidance on How to Judge Significance

13. It was noted on the IOSCO conference call that additional guidance could be provided on how to evaluate the significance of a breach. It was also noted that the guidance did not indicate the denominator – i.e., significance in relation to what?
14. The Task Force has considered the matter. The Task Force is of the view that significance is contextual and ¶290.42 contains the following detailed list of factors that will influence the significance of the breach:
  - The nature and duration of the breach;
  - The number and nature of any previous breaches with respect to the current audit engagement;
  - Whether a member of the audit team had knowledge of the interest or relationship that caused the breach;
  - Whether the individual who caused the breach is a member of the audit team or another individual for whom there are independence requirements;
  - If the breach relates to a member of the audit team, the role of that individual;
  - If the breach was caused by the provision of a professional service, the impact of that professional service, if any, on the accounting records or the amounts recorded in the financial statements on which the firm will express an opinion; and
  - The extent of the self-interest, advocacy, intimidation or other threats created by the breach.
15. The Task Force is of the view that it is implicit that the significance of the breach is to be evaluated relative to independence. The drafting is consistent with the conceptual framework of the Code which requires the identification of threats to compliance fundamental principles, the evaluation of the significance of the threats identified, and the application of safeguards. The Task Force is of the view that it is not necessary to provide any further guidance in this respect and is, therefore, not proposing any changes in this area.

#### Additional Guidance on When Resignation is Necessary

16. It was noted on the IOSCO conference call that additional guidance could be provided on when resignation was necessary. It was noted that the proposals do not indicate that even when the consequences of the breach are highly significant, resignation is needed.
17. The Task Force has considered the matter. The Task Force notes that the proposals indicate that resignation may be necessary (¶290.39, ¶290.43 and ¶290.45). Whether resignation is necessary is dependent upon having evaluated both the significance of the breach and whether action can be taken to satisfactorily address the consequences of the breach. The Task Force does not,

therefore, think that it is possible to categorically describe a fact pattern when resignation would always be necessary. The Task Force is, therefore, not proposing any changes in this area.

**Matter for IESBA Consideration**

The IESBA is asked to consider the Task Force's views.

**Voting Procedures**

18. IESBA members are asked to approve the proposed changes to the Code. Due process requires an affirmative vote of two-thirds of IESBA members (twelve) to approve the document.
19. After approval of the final document, due process requires the IESBA to consider whether re-exposure is necessary. Situations that constitute potential ground for a decision to re-expose include:
  - Substantial change to a proposal arising from matters not aired in the exposure draft, such that commentators have not had an opportunity to make their views known to the IESBA before it reaches a final conclusion;
  - Substantial changes arising from matters not previously deliberated by the IESBA; or
  - Substantial change to the substance of the proposed change to the Code.
20. The Task Force is of the view that under the terms of reference re-exposure is not necessary.
21. Each change to the Code is accompanied by a basis for conclusions. The IESBA does not vote on this document but it is provided to Board members for comment and input. This document will be circulated to Board members for their comment before the final pronouncement is released. The release of the final pronouncement is dependent upon PIOB approval that due process was followed in the development of the pronouncement.

*Effective Date*

22. At the June meeting, the IESBA agreed that the effective date be relatively short, and be approximately one year after the release of the final pronouncement. At the CAG meeting in September, a CAG Representative asked whether early adoption could be encouraged. The Task Force recommends that this suggestion be adopted.

**Action Requested**

The IESBA is asked to approve the proposed changes to the Code.

**Material Presented**

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| Agenda Item 2-A | Proposed Changes (Mark-Up) |
| Agenda Item 2-B | Proposed Changes (Clean)   |