



Meeting Location: Conference Call

Meeting Date: October 15, 2012 07:00-09:00 Eastern Time

October 16, 2012 07:00-08:00 Eastern Time (if necessary)

Breach of a Provision of the Code

Objective of Agenda Item

1. To approve proposed changes to the Code to address a breach of a provision of the Code.

Background

At its June 2012 meeting, the IESBA discussed proposed revisions in response to comments received to the Exposure Draft addressing a breach of a provision of the Code. The IESBA agreed that, subject to certain specified changes and any further changes to respond to comments from CAG members, it would support issuing the document in final form. A straw poll confirmed that all present (17 members) would support the document as amended.

The document was discussed on a conference call with IOSCO in July 2012 and by the CAG at its meeting in September 2012, additional input was obtained from IOSCO after the CAG meeting. Agenda Paper 2-C contains the relevant extract from the CAG minutes.

Discussion

Changes Agreed to in June 2012

Agenda Papers 2-A (clean) and 2-B (mark-up) reflect the following changes that were agreed to at the June 2012 IESBA meeting:

- ¶100.10 and 100.11 to be combined into one paragraph;
- ¶290.41 to delete the last sentence and include a statement that the firm shall report a breach to a member body, relevant regulator or oversight authority if such reporting is common practice or expected in the particular jurisdiction. When developing the wording, the Task Force felt that it was appropriate to require the firm to consider such reporting but it was inappropriate to base a requirement on whether a matter was common practice or expected;
- ¶290.42 – penultimate bullet – to revise to refer to any professional service;
- ¶290.45 – to remove the reference to where “permitted by law or regulation” and to state

that those charged with governance shall be informed “as soon as possible”. It was noted by the Taskforce that “permitted by law or regulation” should therefore also be deleted from 290.47;

- ¶290.46 – to delete the sentence “The appropriate timing for the discussion may vary with the nature of the breach”;
- ¶290.47 – to change the construction to make it clear that the policies and procedures to be communicated are the policies and procedures that are relevant to the breach; and
- ¶290.49 – editorial changes to align with ¶290.41 and to require documentation of key decision made.

Other Changes

The document presented to the IESBA in June was discussed by IOSCO and by the CAG. Based on the feedback the Task Force is proposing the following additional changes:

Reporting within the Firm

¶290.42 In their comment letter, IOSCO expressed the view that the firm’s assessment and determination of the outcome of the breach should be elevated within the firm for example to the firm’s quality control function and or firm’s leadership. In June, the IESBA was of the view that it was not appropriate to address this in the Code because it is addressed in detail in ISQC1. The matter was raised in the July conference call with IOSCO and the Task Force reconsidered the matter. The Task Force proposed amending ¶290.42 to read:

“When a breach is indentified 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 and promptly communicate a breach to the engagement partner and other relevant personnel in the firm...”

The Task Force was of the view that this is consistent with the approach taken in ISQC1. This language was presented to the CAG in September, noting with it was a Task Force proposal that had not yet been discussed by the IESBA. The IOSCO members on the CAG expressed appreciation for the changes that were proposed but felt did not completely address the point in two regards

- Firstly, the proposed change did not assign responsibility for who should report the breach and who within the firm should receive notification of the breach – for example an ethics partner or the individual within the firm who have responsibility for quality control. It was noted that the Code does not generally assign responsibility, and that this is a matter which will be under consideration as the project to reformat the Code progresses. It was also noted that the Code should not conflict with ISQC1.
- Secondly, there is no reference to what should be included in the policies and procedures. It was noted that ISQC1 contains requirements and application guidance on the firm’s policies and procedures.

To try and address the IOSCO concerns, the Task Force recommends the changes that follow to ¶290.42. The Task Force is of the view that it would be inappropriate for the Code to go beyond

the requirements in ISQC1. In addition, the matter of specific responsibility is an issue that relates to all of the Code and it would be inappropriate to address it in a piece-meal fashion by amending only the provisions that address breaches.

“When a breach is indentified 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 and promptly communicated the breach~~ to the engagement partner, ~~the individual assigned responsibility for 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 the appropriate action.”

Terminating the Audit Engagement

IOSCO expressed concern that, having identified a breach and evaluated the significance of the breach (¶290.42), the next two paragraphs address the determination of whether actions can be taken to satisfactorily address the consequences of the breach (¶290.43 and 44). It is not until ¶290.45 that this series of paragraphs indicates that there may be instances where action cannot be taken to satisfactorily address the consequences of the breach. The Task Force notes that the opening paragraph (¶290.39) indicates that a consequence of a breach may be that termination is necessary. However, to emphasize the matter further, and to address the issue raised by IOSCO, the Task Force recommends the following changes to ¶290.43:

“Depending upon the significance of the breach ~~it may be necessary to terminate the audit engagement or~~ it may be possible to take action that satisfactorily addresses the consequence of the breach.”

Editorial

¶290.42 – The Task Force recommends inserting “any” to make it clear there may not have been any previous breaches.

¶290.47 – A CAG member noted that all of the matters discussed with those charged with governance (¶290.46) are not contained in the paragraph addressing the communication in writing. To address this matter, the Task Force proposes adding “communicated in writing with those charged with governance all matters discussed...”

¶291 – The Task Force has reviewed Section 291 and to ensure consistency with the changes to 290 recommends the conforming changes presented in mark-up in Agenda Paper 2-B.

Public Reporting of all Breaches

At the CAG meeting, an IOSCO member stated that some IOSCO members feel that it is important that breaches are reported publicly. In some jurisdictions, for example Australia, certain breaches of independence are required by the law or stock exchange to be disclosed publicly. It was noted at the CAG meeting that this matter has been debated by the Task Force and the IESBA previously and the IESBA is of the view that it is inappropriate to require public reporting in a global Code. If a regulator in a particular jurisdiction believes public reporting is appropriate in that jurisdiction, the regulator should require such reporting.

Action Requested

IESBA members are asked to consider the proposed changes.

Voting Procedures

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.

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.

The Task Force is of the view that under the terms of reference re-exposure is not necessary.

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 - 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 member asked whether early adoption could be encouraged. The Task Force recommends that this suggestion be adopted.

Material Presented

Agenda Paper 2	This Agenda Paper
Agenda Paper 2-A	Breaches draft (clean)
Agenda Paper 2-B	Breaches draft (mark-up from version discussed in June 2012)
Agenda Paper 2-C	CAG September 2012 – Extract from Draft Minutes

Action Requested

1. IESBA members are asked to approve the proposed changes to the Code.