



28 October 2011

To: **Members of the Hong Kong Institute of CPAs**  
**All other interested parties**

**INVITATION TO COMMENT ON IFAC'S INTERNATIONAL  
ETHICS STANDARDS BOARD FOR ACCOUNTANTS (IESBA)  
EXPOSURE DRAFT ON PROPOSED CHANGES TO THE CODE  
OF ETHICS FOR PROFESSIONAL ACCOUNTANTS RELATED  
TO PROVISIONS ADDRESSING A BREACH OF A  
REQUIREMENT OF THE CODE**

***Comments to be received by 23 December 2011***

The Hong Kong Institute of Certified Public Accountants' (Institute) Ethics Committee is seeking comments on the IFAC's IESBA Exposure Draft on Proposed Changes to the Code of Ethics for Professional Accountants (IESBA Code) which has been posted on the Institute's website at:

<http://www.hkicpa.org.hk/en/standards-and-regulations/standards/code-of-ethics/exposure-drafts/>.

The Explanatory Memorandum to the Exposure Draft provides background information and explanation of, the proposed changes to various paragraphs in the IESBA Code that address a breach of a requirement of the IESBA Code.

In 2010, the IESBA assessed the provisions in the IESBA Code that address a breach of an independence requirement, and concluded that a project should be undertaken to reconsider those provisions. As a result of this project, the IESBA concluded that it is in the public interest to have an appropriate mechanism that can be consistently applied across all jurisdictions in order to provide companies, auditors, regulators, and similar authorities with a framework to evaluate the impact of an independence violation and determine whether the auditor's resignation is the only appropriate outcome.

In addition, the IESBA believes that any breach of a provision of the IESBA Code should be treated as a matter of utmost importance. Therefore, the IESBA has proposed changes to the IESBA Code that will provide guidance to a professional accountant on the action to be taken in such situations. This includes a robust framework for addressing a breach of an independence requirement that will result in greater transparency. The proposed framework will guide accountants, and those charged with governance, in determining whether resignation is an appropriate outcome or whether a different outcome can be supported. In addition, disclosure will enhance transparency, and the proposed documentation requirement adds a degree of rigor to the process that will be very useful.



The proposed changes include a requirement that a professional accountant take whatever actions that might be available as soon as possible to satisfactorily address the consequences of a breach of a provision of the IESBA Code. For a breach of an independence requirement in the IESBA Code, a detailed framework is provided setting out the action to be taken. Specifically, the proposed changes would require a firm to:

- terminate, suspend, or eliminate the interest or relationship that caused the breach;
- evaluate the significance of the breach and determine whether action can be taken to satisfactorily address the consequences of the breach;
- communicate all breaches with those charged with governance and obtain their agreement with the proposed course of action; and
- document the actions taken and all the matters discussed with those charged with governance and, if applicable, any relevant regulators.

The IESBA intends to finalize the revisions to the IESBA Code in the first half of 2012 and proposes that the changes be effective for breaches identified on and after 1 January 2013.

The IESBA invites all stakeholders to comment on its proposals. In particular, it would be helpful if respondents' comments could include the areas set out in the guide for respondents which are in pages 8 to 9 of the IESBA Exposure Draft.

Comments may be sent by mail, fax or e-mail to:

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Hong Kong Institute of Certified Public Accountants  
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Fax number (+852) 2865 6776  
E-mail: [commentletters@hki CPA.org.hk](mailto:commentletters@hki CPA.org.hk)

Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

28 October 2011  
Exposure Draft

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Response Due Date  
23 December 2011

*ED of Proposed Changes to the Code of Ethics*

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# **Proposed Changes to the Code of Ethics for Professional Accountants Related to Provisions Addressing a Breach of a Requirement of the Code**



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

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IESBA Press releases

This Exposure Draft may be filed in the “Exposure Drafts, Invitations to Comment” section of Volume I of the Institute Members’ Handbook.

The Exposure Draft can also be found on the Institute’s website at:

<http://www.hkicpa.org.hk/en/standards-and-regulations/standards/code-of-ethics/exposure-drafts/>

*International Ethics Standards Board for Accountants*

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Proposed Changes to the Code of  
Ethics for Professional Accountants  
Related to Provisions Addressing a  
Breach of a Requirement of the Code



International Federation  
of Accountants

## REQUEST FOR COMMENTS

The International Ethics Standards Board for Accountants (IESBA) approved this exposure draft, *Proposed Changes to the Code of Ethics for Professional Accountants Related to Provisions Addressing a Breach of a Requirement of the Code*, for publication at its October 2011 meeting. This proposal may be modified in light of comments received before being issued in final form.

Respondents are asked to submit their comments **electronically** through the IFAC website ([www.ifac.org](http://www.ifac.org)) using the “Submit a Comment” link on the Exposure Drafts and Consultation Papers page. Please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the IFAC website. Although the IESBA prefers that comments be submitted electronically, comments also may be submitted by e-mail to [janmunro@ifac.org](mailto:janmunro@ifac.org).

Comments should be submitted by **January 23, 2012**.

Copies of this exposure draft may be downloaded free of charge from the IESBA website at [www.ethicsboard.org](http://www.ethicsboard.org).

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# **EXPLANATORY MEMORANDUM**

## **Introduction**

This memorandum provides background for, and an explanation of, the proposed changes to various paragraphs in the Code of Ethics for Professional Accountants (the Code) that address a breach of a requirement of the Code. The International Ethics Standards Board for Accountants (IESBA) approved these proposed changes in October 2011 for exposure.

The IESBA welcomes all comments on the proposed changes. In addition to general comments, the IESBA welcomes comments on the specific questions that are contained at the end of this memorandum.

## **Background**

The Code contains several paragraphs that address an inadvertent violation of a provision of the Code. For example, paragraph 110.10 provides that such a violation "may be deemed not to compromise compliance with the fundamental principles provided . . . [it] is corrected promptly and any necessary safeguards are applied. Paragraph 290.39 contains similar guidance for when there is an inadvertent violation of an independence requirement in the Code, including requiring, among other things, that "the firm has appropriate quality control policies and procedures in place." Similar guidance is located in paragraphs 290.117, 133, and 159, and 291.33, 112, and 127.

Those paragraphs were commented on in a letter submitted to the IESBA by the International Organization of Securities Commissions in response to an IESBA Exposure Draft issued in July 2008, which proposed new drafting conventions for the Code. IOSCO expressed concern that the paragraphs could be read to imply that all inadvertent violations can be corrected through the application of any necessary safeguards. This, in turn, might encourage unscrupulous behavior and potential abuse in complying with the Code. It also might reduce a firm's motivation to establish robust preventive controls to properly identify threats to independence. The IESBA considered IOSCO's comments and at its October 2010 meeting approved the commencement of a project to address the concerns expressed.

## **Significant Matters**

### **Need for Provisions**

The current paragraphs address a violation of any requirement in the Code. The IESBA began this project by first considering whether the Code should contain such paragraphs. In doing so, the IESBA first considered whether the Code should contain provisions to address a violation of an independence requirement and then considered whether there should be provisions that address violations of other requirements in the Code.

In respect of violations of independence requirements, the IESBA concluded that it is in the public interest to have a robust framework that can be applied across all jurisdictions in order to assist those charged with governance, auditors, and regulators in evaluating the impact of an independence violation and determining whether it should result in the auditor resigning or whether actions can be taken to satisfactorily address the consequences of the violation. If the automatic response to any violation of an independence requirement is that the firm must resign,



regardless of the magnitude of the violation and its impact on the firm's objectivity, the IESBA believes the public interest is not well served.

Some authorities (e.g., the U.S. Securities and Exchange Commission, the U.S. Government Accountability Office, the UK Auditing Practices Board, and the Australian Accounting Professional and Ethical Standards Board) have built into their standards and regulations provisions that set out mandatory processes for dealing with violations. Not all jurisdictions, however, have a regulator that is able to deal with violations and not all regulators have a regulatory process for dealing with them. In those situations, those charged with governance and audit firms are left to address violations on an ad hoc basis; there is no guidance on the steps that must be taken if the firm has identified a violation. The IESBA is of the view that the Code should provide such a framework to promote consistent analysis and outcomes.

Having concluded that the Code should contain a provision that addresses the implications of a violation of an independence requirement in the Code, the IESBA considered whether there should be a provision to address violations of other requirements in the Code. The IESBA believes it is important for the Code to include a general provision to promote ethical behavior by professional accountants if a violation of other requirements in the Code occurs.

### **Use of the term “inadvertent” and "violation"**

The current paragraphs address inadvertent violations of a requirement in the Code. The Board considered how a provision that applies only to inadvertent violations could be made more operational and more effective. In considering this matter the IESBA concluded that a provision that focuses on inadvertent violations causes a focus on whether the violation was inadvertent or not. The IESBA believes that this inappropriately diverts attention away from the violation itself, which, regardless of how it arose, requires evaluation to understand its impact on the firm's objectivity and a determination of whether resignation is necessary or whether actions can be taken to satisfactorily address the consequences of the violation. In the Board's view, whether the action causing the violation was inadvertent or not should not affect this. Accordingly, the IESBA proposes to discontinue use of the term "inadvertent."

The IESBA also considered whether the term "violation" should be revised. Some paragraphs in the Code, for example, 100.16 and 100.21, use the term "breach" to convey situations involving infractions of the Code. The IESBA is of the view that “breach” is a better term and would improve the consistency of terminology used in the Code. The Exposure Draft, therefore, adopts this term.

### **Proposed Requirements**

#### **Overall Provision**

Paragraph 100.10 states that if a professional accountant inadvertently violates a provision of the Code “depending on the nature and significance of the matter, such an inadvertent violation may be deemed not to compromise compliance with the fundamental principles provided, once the violation is discovered, the violation is corrected promptly and any necessary safeguards are applied.” The IESBA is of the view that any breach of a provision of the Code should be treated as a matter of utmost importance and that the Code should promote responsible behavior by the accountant whenever a breach occurs. Therefore, the IESBA concluded that the provision in paragraph 100.10 should be replaced with a requirement that a professional accountant take whatever actions that might be available as soon as possible to satisfactorily address the

consequences of a breach of a provision of the Code. The provision should also require the accountant to determine whether to report the breach to those who may have been affected by the breach.

### Independence Provisions

Paragraph 290.39 states that if an inadvertent violation occurs “it generally will be deemed not to compromise independence provided the firm has appropriate quality control policies and procedures in place, equivalent to those required by International Standards on Quality Control, to maintain independence and, once discovered, the violation is corrected promptly, and any necessary safeguards are applied to eliminate any threat or reduce it to an acceptable level.” The IESBA notes that this does not make it clear that depending on the nature and severity of the consequences of a breach, termination of the audit engagement might be necessary or reporting to a regulator or other body might be required. In addition there is no requirement to discuss the matter with those charged with governance and no documentation requirement, both of which the IESBA believes are necessary rigors in addressing the consequences of a breach. The IESBA concluded that this provision should be replaced with an approach that provides a robust, transparent mechanism for addressing breaches.

The proposal requires a firm to determine whether termination of the audit engagement is necessary or whether action can be taken to satisfactorily address the consequences of a breach such that the firm can still issue an audit opinion. When a breach of an independence provision is identified, the firm would be required to:

- terminate, suspend or eliminate the interest or relationship that caused the breach;
- comply with any applicable legal or regulatory requirements with respect to the breach;
- evaluate the significance of the breach and its impact on the firm's objectivity and determine whether action can be taken to satisfactorily address the consequences of the breach;
- communicate with those charged with governance and obtain their agreement with the proposed course of action; and
- document the action taken and all the matters discussed with those charged with governance and, if applicable, any relevant regulators.

In determining whether action can be taken to satisfactorily address the consequences of the breach, the firm is required to take into account whether, even if such action can be taken, a reasonable and informed third party, weighing the significance of the breach, would be likely to conclude that the firm's objectivity would be compromised such that the firm is unable to issue an audit report. The IESBA is of the view that this is an appropriately high threshold for making the determination and is consistent with the general thrust of the Code, which requires an accountant's judgments to take into account the views of a reasonable and informed third party.

The proposal requires a firm to discuss all breaches with those charged with governance. The IESBA considered whether, consistent with the reporting requirements or practice in some jurisdictions, there should be a *de minimis* test whereby insignificant breaches are not disclosed to those charged with governance. The IESBA concluded that such an approach would entail too much subjectivity as to whether a breach was significant or insignificant and thus whether it was necessary to report the breach. The IESBA also considered whether those charged with

governance should determine which breaches should be communicated by the firm. Requiring disclosure of all breaches addresses the perceived self-interest that some may believe a firm has not to report a breach. The IESBA, therefore, concluded that all breaches should be discussed with those charged with governance irrespective of the significance of the breach.

When discussing a breach with those charged with governance, the proposal requires a firm to discuss, among other matters:

- the significance of the breach, including its nature and duration;
- how the breach occurred and how it was detected;
- a description of the firm's relevant policies and procedures designed to provide it with reasonable assurance that independence is maintained;
- steps taken or to be taken to address any identified weaknesses in the firm's policies and procedures; and
- any additional action that those charged with governance may request the firm to take.

The IESBA is of the view that such communication will enhance the transparency of the firm's analysis and judgments. It also engages others outside of the firm, who may have legal obligations related to auditor independence, which adds additional rigor to the process of addressing a breach.

The proposal provides that the firm may continue with the audit engagement only if those charged with governance agree that action can be taken to satisfactorily address the consequences of the breach and such action is taken. If those charged with governance do not agree that the action satisfactorily addresses the consequences of the breach, the firm is required to take the steps necessary to terminate the audit engagement in compliance with any applicable legal or regulatory requirements relevant to terminating an audit engagement.

If the breach occurred prior to the issuance of the previous audit report, the proposal requires the firm to evaluate the significance of the breach and its impact on the firm's objectivity and its ability to issue an audit report in the current period. The firm would also need to consider the impact of the breach, if any, on the previously issued audit report, including whether withdrawal of that report is warranted. The firm would also be required to discuss the breach with those charged with governance.

The IESBA considered whether the detailed provisions for addressing a breach of an independence requirement in Section 290 should also be used in Section 291. The Board concluded that the nature of the assurance services covered by Section 290 and the importance of those services to the broader public interest warrant inclusion in that section of a detailed description of the framework to be used for dealing with a breach of an independence requirement. Consistent with how the Code has been developed, the Board determined that an abbreviated discussion of that framework is suitable for Section 291.

#### Documentation

The proposal requires documentation of all identified breaches, the actions taken with respect to the breaches, and all matters discussed with those charged with governance and, if applicable, with relevant regulators. The IESBA is of the view that such a requirement strengthens the proposal. A documentation requirement for accountants imposes a discipline that promotes a high degree of care when identifying relevant facts, performing necessary evaluations, and

determining the appropriate action in response to a breach. It also provides a record that can be reviewed by those who inspect the audit engagement, whether in a peer review or an inspection performed by a regulator. Thus, documentation instills an additional rigor into the process, which the IESBA believes is consistent with the importance of addressing breaches in a credible, robust, and consistent manner.

#### Disciplinary action

The proposed provisions do not address any disciplinary action that might be appropriate to take against the individual who caused the breach. Such matters are the purview of professional bodies, audit firms, and regulators who enforce the Code, and are not within the remit of the IESBA.

### **Analysis of the Overall Impact of the Proposed Changes (Impacts are presented in tabular format in the Appendix)**

The IESBA is piloting testing the use of impact analyses to convey the results of the Board's assessment of the potential impact that a proposed amendment to the Code might have. The impact analysis contained in this explanatory memorandum shows the IESBA's consideration of the potential impact of the proposal in this exposure draft. It is in a tabular format, identifies who will be affected by the proposal, how, and to what extent, and is located in the Appendix.

### **Effective Date**

The IESBA proposes that the changes be effective for breaches identified on and after January 1, 2013. While the proposal requires increased transparency through reporting to those charged with governance and documentation, the IESBA believes that the proposal does not necessitate significant changes in firms' systems and processes. The IESBA is therefore of the view that a relatively short transition period is appropriate.

### **Project Timetable**

Subject to comments received on exposure of proposed changes, the IESBA intends to finalize the revisions to the Code in the first half of 2012.

### **Guide for Respondents**

The IESBA welcomes comments on all matters addressed in the exposure draft. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with a proposal in this exposure draft (especially those calling for change in current practice), it will be helpful for the IESBA to be made aware of this view.

### **Request for Specific Comments**

The IESBA would welcome views on the following questions:

1. Do respondents agree that the Code should contain provisions that require professional accountants to address the consequences of a breach of a requirement in the Code? If not why not?

2. Do respondents agree with the overall approach proposed to deal with a breach of an independence requirement, including the proposal that the firm may continue with the audit engagement only if those charged with governance agree that action can be taken to satisfactorily address the consequences of the breach and such action is taken?
3. Do respondents agree that a firm should be required to communicate all breaches of an independence requirement to those charged with governance? If not, why not and what should be the threshold for reporting?
4. Do respondents agree that the reasonable and informed third party test should be used in determining whether an action satisfactorily addresses the consequences of a breach of an independence requirement? If not, why not and what should the test be?
5. Do respondents agree that the matters that should be discussed with those charged with governance as proposed in section 290.46 are appropriate? If not, why not? Are there other matters that should be included, or matters that should be excluded?
6. Do respondents agree with the impact analysis as presented? Are there any other stakeholders, or other impacts on stakeholders, that should be considered and addressed by the IESBA?
7. Would the proposal require firms to make significant changes to their systems or processes to enable them to properly implement the requirements? If so, does the proposed effective date provide sufficient time to make such changes?
8. Is the abbreviated version of the framework described in Section 290 for dealing with a breach of an independence requirement suitable for Section 291? If not, what do respondents believe Section 291 should contain?

**Analysis of Impacts of Revisions to the Code Addressing a Breach of a Provision of the Code**

<b>Current Standard</b>	<b>Proposed Change</b>	<b>Impacts</b>	<b>Party/Interest Impacted</b>	<b>Significance</b>	<b>Duration</b>
<p>100.10 provides a mechanism for dealing with an inadvertent violation of the Code</p> <p>It provides that depending on its nature and significance, an inadvertent violation may be deemed not to compromise compliance with the fundamental principles provided it is corrected promptly and any necessary safeguards are applied.</p>	<p>Remove the general provision 100.10 from the Code on the basis that:</p> <p>it is difficult to conceive of inadvertent violations of matters involving the fundamental principles, particularly integrity.</p> <p>it is not desirable to provide a defense for such violations when these are fundamental principles in the Code that must be complied with.</p>	<p><b>Cost</b></p> <p>The consequences of a violation would need to be addressed, which will require time and effort.</p> <p><b>Confidence in financial reports</b></p> <p>Increased on basis that there on no defenses to, for instance, failure to use diligence and care in providing a professional service.</p> <p><b>Transparency</b></p> <p>Increased on similar basis to above; accountants not being seen to have a ‘way out’ in instances of breaches</p>	<p><b>Auditors/ accountants</b></p> <p>Will no longer have an avenue for defending inadvertent violations of a fundamental principle in the Code</p> <p><b>Clients</b></p> <p>Should have a positive impact on their confidence in the profession</p> <p><b>Investors</b></p> <p>Should have a positive impact on their confidence in the profession and in the work produced by professional accountants for the companies they</p>	<p>High in terms of enhancing the reputation for professionalism in the accounting profession</p>	<p>Ongoing</p>

		<p>of the fundamental principles in the Code.</p> <p><b>Ease of working with standard</b></p> <p>Arguable as it is not clear how accountants have used the provision. There are no additional processes described in the Code for addressing a violation.</p> <p><b>Accountant/auditor professionalism</b></p> <p>Increased as violations of fundamental principles are not seen as defensible per se.</p> <p><b>Convergence</b></p> <p>Perhaps an increase given that various jurisdictions may have their particular ways of dealing with a violation of a provision in the</p>	<p>invest in.</p> <p><b>Oversight Bodies</b></p> <p>May welcome this removal on the basis that it risks the perception that accountants are able to avoid compliance with the fundamental principles of the Code by using the inadvertent violation defense.</p> <p><b>Public Interest</b></p> <p>Similarly public interest is served by removing what might be construed as a mechanism for avoiding compliance with the fundamental principles of the Code, thereby enhancing the standard of professionalism in the accounting profession and in turn promoting confidence in the profession by its</p>		
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		Code.	stakeholders.		
290.39 provides that where an auditor inadvertently violates an independence provision of the Code, the violation may nevertheless be deemed not to compromise independence in circumstances where appropriate quality control policies and procedures are in place, the violation is corrected promptly, and safeguards are applied to eliminate the threat or reduce it to an acceptable level.	Retain a provision dealing with a violation of an independence requirement but with substantial modifications including removing the deeming concept, requiring all violations of independence requirements to be addressed, not just inadvertent ones, placing the onus on the auditor to show why the firm nevertheless is able to continue the audit, engaging those charged with governance, and requiring documentation.	<p><b>Cost</b></p> <p>May increase for audit firms in terms of documentation and potential rework. Clearer guidance that firm resignation may be necessary could impact clients in dealing with potential resignation of the audit firm.</p> <p>There may be a cost to regulators in dealing with breaches that some firms decide to voluntarily report to the regulator absent a requirement to do so.</p> <p><b>Confidence in financial reports</b></p> <p>This should increase in response to greater confidence in auditor independence when</p>	<p><b>Auditors/ accountants</b></p> <p>Significant impact through more robust process</p> <p><b>Clients</b></p> <p>Positive in terms of greater transparency by their auditors</p> <p>Positive in terms of those charged with governance getting more engaged with auditor independence matters and considering how breaches of independence requirements affect the auditor's objectivity. Actual number of breaches is thought to be low</p> <p><b>Investors</b></p> <p>Positive impact by providing a process that in some cases may enable an audit</p>	High in terms of better serving the public interest in dealing with violations of auditor independence	On going with some potential systems changes in the early stages of adoption



		<p>preparing audit reports</p> <p><b>Transparency</b></p> <p>Increased significantly</p> <p><b>Ease of working with Code</b></p> <p>Increased through a comprehensive and documented process for dealing with violations consistent for all jurisdictions.</p> <p><b>Accountant/auditor professionalism</b></p> <p>Increased through a more robust, transparent and equitable process.</p> <p><b>Convergence</b></p> <p>Perhaps an increase given that various jurisdictions may have their particular ways of dealing with violations under this provision, which would become uniform under the</p>	<p>firm to continue with an audit and hence the company avoids the cost and delay associated with finding a new auditor, allowing audited financial statements to be delivered timely</p> <p>Potentially negative where there is an auditor resignation as a result of a violation, because investors ultimately bear the cost of switching auditors, including monetary costs, delays in releasing the financial statements, and any stock trading suspension.</p> <p><b>Oversight Bodies</b></p> <p>May welcome this removal on the basis that it addresses concerns that accountants are able to avoid compliance with the fundamental</p>		
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		changes to the Code.	<p>principles of the Code by using the inadvertent violation defense.</p> <p><b>Public Interest</b></p> <p>Served by removing what might be construed as a mechanism for avoiding compliance with the fundamental principles of the Code, thereby enhancing the standard of professionalism in the accounting profession and in turn promoting confidence in the profession by its stakeholders</p>		
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<p>290.39 provides that independence will be deemed not to be compromised in certain circumstances.</p>	<p>Remove the “deeming” concept and require the firm to evaluate the significance of a breach and its impact on the firm’s objectivity and ability to issue an audit report.</p>	<p><b>Cost</b> Arguably increased because of greater effort/work in undertaking the evaluation.</p> <p><b>Confidence in financial reports</b> Increased because of evaluation of the impact on objectivity.</p> <p><b>Transparency</b> Increased because particular issues involved are evaluated, discussed with those charged with governance, and documented.</p> <p><b>Ease of working with Code</b> Potentially more difficult because of increased work effort. Easier by having a clear process to follow.</p>	<p><b>Auditors/ accountants</b> Significant through process requirements, enhanced credibility and transparency.</p> <p><b>Clients</b> More appropriate outcomes in relation to auditor independence.</p> <p><b>Investors</b> Greater assurance of financial reporting and audit quality.</p> <p><b>Oversight Bodies</b> Oversight of a more transparent process.</p> <p><b>Public Interest</b> Served by having a robust and more transparent process that can produce consistent outcomes.</p>	<p>High.</p>	<p>On-going.</p>
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		<p><b>Accountant/auditor professionalism</b></p> <p>Impacted by increased confidence by users in outcomes.</p> <p><b>Convergence</b></p> <p>Elimination of the concept brings the Code more in line with standards and regulations of other bodies..</p>			
290.39 provides that the firm shall determine whether to discuss the matter with those charged with governance.	The firm is required to discuss a breach with those charged with governance as soon as possible (matters to be discussed are listed in 290.46), and if resignation is not required, obtain their agreement that action to be taken will satisfactorily address the consequences of the breach..	<p><b>Cost</b></p> <p>Increased cost due to the work in discussing and documenting.</p> <p><b>Confidence in financial reports</b></p> <p>Increased given that there will be greater transparency regarding the firm's judgments about its objectivity and independence.</p> <p><b>Transparency</b></p> <p>Increased by</p>	<p><b>Auditors/ accountants</b></p> <p>Significant because of the requirement to discuss with those charged with governance and obtain their concurrence with the auditor's judgments.</p> <p><b>Clients</b></p> <p>Significant through the involvement of those charged with governance.</p>	Very high	On-going.

		<p>engaging those charged with governance in the matter.</p> <p><b>Ease of working with Code</b></p> <p>Enhanced as requirements are clear and eliminated ad hoc practices of dealing with independence breaches.</p> <p><b>Accountant/auditor professionalism</b></p> <p>Arguably enhanced by the long term effects of involving accountable parties outside of the firm.</p> <p><b>Convergence</b></p> <p>Enhanced by consistency of process. Required communication with those charged with governance is consistent with the regulations in some major jurisdictions.</p>	<p><b>Investors</b></p> <p>As those charged with governance represent investors, increased comfort through greater engagement of those charged with governance in auditor independence matters.</p> <p><b>Oversight Bodies</b></p> <p>Significant in that accountable parties outside of the audit firm have weighed in regarding a breach.</p> <p><b>Public Interest</b></p> <p>Significant through greater accountability of the audit firm with respect to independence.</p>		
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<p>290.39 does not specifically refer to resignation of the auditor or termination of the audit engagement.</p>	<p>If the firm determines that actions cannot be taken to address the consequences of the breach, 290.45 makes it clear that the firm shall terminate the audit engagement.</p>	<p><b>Cost</b> Potentially very high, although unclear how often firms resigned under the current provision.</p> <p><b>Confidence in financial reports</b> Higher in the short- and long-term because a provision that reinforces that resignation may be necessary depending on the situation will mean that greater comfort can be taken that firms that are not able to be objective as a result of a breach did not perform the audit.</p> <p><b>Transparency</b> High.</p> <p><b>Ease of working with Code</b> Little impact on the Code per se.</p>	<p><b>Auditors/ accountants</b> Significant because of the potential resignation.</p> <p><b>Clients</b> Significant because of potential loss of auditors and reengagement of new auditors. Potential negative impact because of potential failure to release financial results timely. Potential damage to client reputation in the marketplace if unexpected resignation occurs.</p> <p><b>Investors</b> Greater perceived validity of financial results but negative impact on investment activity if unexpected resignation occurs.</p>	<p>Extreme</p>	<p>On-going.</p>
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		<p><b>Accountant/auditor professionalism</b></p> <p>Very high in the longer term.</p> <p><b>Convergence</b></p> <p>Enhanced by requirement being clear and setting a high hurdle to overcome, which could become a best practice</p>	<p><b>Oversight Bodies</b></p> <p>Greater accountability for audit firms.</p> <p><b>Public Interest</b></p> <p>Greater assurance of maintenance of auditor independence generally and that only auditors who have the ability to be objective after a breach are performing the audits.</p>		
290.39 does not require documentation in relation to a breach.	The firm shall document the actions it took and all the matters discussed with those charged with governance and, if applicable, regulators.	<p><b>Cost</b></p> <p>Increased due to the work required to document and the care that such documentation will require.</p> <p><b>Confidence in financial reports</b></p> <p>Likely increased because documentation will mean increased</p>	<p><b>Auditors/ accountants</b></p> <p>Significant because a documentation requirement puts an added rigor into the process of dealing with a breach and will inform audit regulators, who could challenge the firm and audit committee's judgments.</p>	High	On-going.

		<p>scrutiny of firm processes.</p> <p><b>Transparency</b></p> <p>Increased by having clear documentation of factors that led to the breach and the corrective measures adopted.</p> <p><b>Ease of working with Code</b></p> <p>Enhanced as requirements are clear.</p> <p><b>Accountant/auditor professionalism</b></p> <p>Arguably enhanced by the greater detail and clarity of factors that contribute to breaches and appropriate remedial actions.</p> <p><b>Convergence</b></p> <p>Documentation is increasingly seen as an effective contributor to discipline in carrying</p>	<p><b>Clients</b></p> <p>Not high.</p> <p><b>Investors</b></p> <p>Greater confidence that the processes for dealing with breaches will be carried out appropriately.</p> <p><b>Oversight Bodies</b></p> <p>If such documentation becomes available to oversight bodies, it may assist them in understanding causative and remedial factors in relation to audit breaches and provide insight into a firm's quality control systems. The potential for review of the documentation by an oversight body would instill discipline in the entire process of a firm addressing a</p>		
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		out a process.	breach of an independence requirement. <b>Public Interest</b> Documentation of causes and remedies for breaches is likely to lead in the long term to improved firm policies and procedures that support auditor independence.		
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**PROPOSED CHANGES TO THE CODE OF ETHICS FOR  
PROFESSIONAL ACCOUNTANTS RELATED TO PROVISIONS  
ADDRESSING A BREACH OF AN INDEPENDENCE REQUIREMENT**

*Paragraph 100.10 would be deleted and replaced with the following:*

100.10 Sections 290 and 291 contain provisions with which a professional accountant shall comply if the professional accountant identifies a breach of an independence provision of the Code. If a professional accountant identifies a breach of any other provision of this Code, the professional accountant shall take whatever actions that might be available, as soon as possible, to satisfactorily address the consequences of the breach, including determining whether to report the breach to those who may have been affected by the breach.

*Paragraph 290.39, and its heading, would be deleted and replaced with the following heading and paragraphs 290.39-290.50.*

**Breach of a Provision of this Section**

290.39 A breach of a provision of this section may occur despite the firm having policies and procedures designed to provide it with reasonable assurance that independence is maintained. A consequence of such a breach may be that termination of the audit engagement is necessary.

290.40 If the firm concludes that a breach has occurred, the firm shall communicate the matter to those charged with governance and terminate, suspend or eliminate the interest or relationship that caused the breach and address the consequences of the breach.

290.41 When a breach is identified, the firm shall consider whether there are any legal or regulatory requirements that apply with respect to the breach and, if so, shall comply with those requirements.

290.42 When a breach is identified, the firm shall evaluate the significance of that breach and its impact on the firm's objectivity and ability to issue an audit report. The significance of the breach will depend on factors such as:

- The nature and duration of the breach;
- The number and nature of 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; and

- If the breach was caused by a non-assurance service, the impact of that non-assurance service on the accounting records or amounts recorded in the financial statements on which the firm will express an opinion.
- 290.43 Depending upon the significance of the breach, it may be possible to take action that satisfactorily addresses the consequences of the breach. The firm shall determine whether such action can be taken. In making this determination the firm shall consider whether, even if such action can be taken, a reasonable and informed third party, weighing the significance of the breach, would be likely to conclude that the firm's objectivity would be compromised such that the firm is unable to issue an audit report.
- 290.44 Examples of actions that the firm might consider include one or more of the following:
- Removing the relevant individual from the audit team;
  - Conducting an additional review of the affected audit work or re-performing that work to the extent necessary, in either case using different personnel;
  - Recommending that the audit client engage another firm to review or re-perform the affected audit work to the extent necessary; and
  - Where the breach relates to a non-assurance service that affects the accounting records or an amount that is recorded in the financial statements, engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.
- 290.45 If the firm determines that action cannot be taken to satisfactorily address the consequences of the breach, the firm shall, after discussion with those charged with governance, take the steps necessary to terminate the audit engagement in compliance with any applicable legal or regulatory requirements relevant to terminating the audit engagement.
- 290.46 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 proposes to take with those charged with governance as soon as possible. The matters to be discussed shall include:
- The significance of the breach, including its nature and duration;
  - How the breach occurred and how it was detected;
  - A description of the firm's relevant policies and procedures designed to provide it with reasonable assurance that independence is maintained;
  - The conclusion that, in the firm's professional judgment, objectivity has not been compromised and the rationale for that conclusion;
  - The action proposed to be taken and the firm's rationale for why the action will satisfactorily address the consequences of the breach and enable it to issue an audit report;

- Any additional action that those charged with governance request the firm to take; and
  - Any steps that the firm has taken or proposes to take to reduce or avoid the risk of further breaches occurring.
- 290.47 If those charged with governance agree that action can be taken to satisfactorily address the consequences of the breach and such action is taken, the firm may continue with the audit engagement.
- 290.48 If those charged with governance do not agree that the action satisfactorily addresses the consequences of the breach, the firm shall take the steps necessary to terminate the audit engagement in compliance with any applicable legal or regulatory requirements relevant to terminating the audit engagement.
- 290.49 If the breach occurred prior to the issuance of the previous audit report, the firm shall comply with this section in evaluating the significance of the breach and its impact on the firm's objectivity and its ability to issue an audit report in the current period. The firm shall consider the impact of the breach, if any, on any previously issued audit reports, including the possibility of withdrawing such audit reports, and discuss the matter with those charged with governance.
- 290.50 The firm shall document the action taken and all the matters discussed with those charged with governance and, if applicable, discussions with relevant regulators. When the firm continues with the audit, the matters to be documented shall also include the conclusion that, in the firm's professional judgment, objectivity has not been compromised and the rationale for why the action taken satisfactorily addressed the consequences of the breach such that the firm could issue an audit report

*The following paragraphs in the Code will be deleted:*

- 290.117
- 290.133
- 290.159

*Paragraph 291.33, and its heading, would be deleted and replaced with the following heading and paragraphs 291.33-37.*

**Breach of a Provision of this Section**

- 291.33 If a breach of a provision of this section is identified, the firm shall take steps as soon as possible to terminate, suspend or eliminate the interest or relationship that caused the breach, and shall evaluate the significance of that breach and its impact on the firm's objectivity and ability to issue an assurance report. The firm shall determine whether action can be taken that satisfactorily addresses the consequences of the breach. In making this determination, the firm shall consider whether, even if such action can be taken, a reasonable and informed third party, weighing the significance of the breach, would be likely to conclude that the firm's objectivity would be compromised such that the firm is unable to issue an assurance report.
- 291.34 If the firm determines that action cannot be taken to satisfactorily address the consequences of the breach, the firm shall, after discussion with the party that engaged the firm or those charged with governance, as appropriate, take the steps necessary to terminate the assurance engagement in compliance with any applicable legal or regulatory requirements relevant to terminating the assurance engagement.
- 291.35 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 proposes to take with the party that engaged the firm or those charged with governance, as soon as possible. If they agree that action can be taken to satisfactorily address the consequences of the breach, and such action is taken, the firm may continue with the assurance engagement.
- 291.36 If the party that engaged the firm or those charged with governance, as appropriate, do not agree that the action satisfactorily addresses the consequences of the breach, the firm shall take the steps necessary to terminate the assurance engagement in compliance with any applicable legal or regulatory requirements relevant to terminating the assurance engagement.
- 291.37 The firm shall document the actions taken and the matters discussed with the party that engaged the firm or those charged with governance.

*The following paragraphs in the Code will be deleted:*

- 291.33
- 291.112
- 291.127



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# IESBA Proposes Changes to the Code of Ethics for Professional Accountants to Address a Breach of a Requirement in the Code

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### IESBA Proposes Changes to the Code of Ethics for Professional Accountants to Address a Breach of a Requirement in the Code

The International Ethics Standards Board for Accountants (IESBA) today released for exposure *Proposed Changes to the Code of Ethics for Professional Accountants Related to Provisions Addressing a Breach of a Requirement of the Code*. The IESBA believes that any breach of a provision of the *Code of Ethics for Professional Accountants* (IESBA Code) should be treated as a matter of utmost importance. Therefore, the IESBA has proposed changes to the IESBA Code that will provide guidance to a professional accountant on the action to be taken in such situations. This includes a robust framework for addressing a breach of an independence requirement that will result in greater transparency. This Exposure Draft is the result of a project that commenced in 2010.\*

The proposed changes to the IESBA Code include a requirement that a professional accountant take whatever actions that might be available as soon as possible to satisfactorily address the consequences of a breach of a provision of the Code. For a breach of an independence requirement in the IESBA Code, a detailed framework is provided setting out the action to be taken. Specifically, the proposed changes would require a firm to:

- terminate, suspend, or eliminate the interest or relationship that caused the breach;
- evaluate the significance of the breach and determine whether action can be taken to satisfactorily address the consequences of the breach;
- communicate all breaches with those charged with governance and obtain their agreement with the proposed course of action; and
- document the actions taken and all the matters discussed with those charged with governance and, if applicable, any relevant regulators.

"The proposed changes to the IESBA Code should help to ensure that the significance of any breach of an independence requirement is discussed with those charged with governance, and that professional judgment is taken into account when taking action," stated Ken Dakdduk, IESBA Chair. "An auditor resignation due to an independence violation—regardless of the magnitude of the violation—has potential consequences to the company, its investors, and the capital markets. The proposed framework will guide accountants, and those charged with governance, in determining whether resignation is an appropriate outcome or whether a different outcome can be supported. In addition, disclosure will enhance transparency, and the proposed documentation requirement adds a degree of rigor to the process that will be very useful."

#### How to Comment

The IESBA invites all stakeholders to comment on its proposals. To access the exposure draft and submit a comment, visit the [IESBA's website](http://www.ifac.org/Ethics/publications-resources) at [www.ifac.org/Ethics/publications-resources](http://www.ifac.org/Ethics/publications-resources). Comments on the exposure draft are requested by **January 23, 2012**.

#### \*Note to Editors:

In 2010, the IESBA assessed the provisions in the IESBA Code that address a breach of an independence requirement, and concluded that a project should be undertaken to reconsider those provisions, including determining whether the provisions are needed and, if so, how the guidance can be enhanced with regard to scope and application. As a result of this project, the IESBA concluded that it is in the public interest to have an appropriate mechanism that can be consistently applied across all jurisdictions in order to provide companies, auditors, regulators, and similar authorities with a framework to evaluate the impact of an independence violation and determine whether the auditor's resignation is the only appropriate outcome.

#### About the IESBA

The [International Ethics Standards Board for Accountants](http://www.ifac.org) (IESBA) is an independent standard-setting board that develops and issues, in the public interest, high-quality ethical standards and other pronouncements for professional accountants worldwide. Through its activities, the IESBA develops the *Code of Ethics for Professional Accountants*, which establishes ethical requirements for

professional accountants. The structures and processes that support the operations of the IESBA are facilitated by IFAC.

**About IFAC**

IFAC is the global organization for the accountancy profession, dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies. It is comprised of 164 members and associates in 125 countries and jurisdictions, representing approximately 2.5 million accountants in public practice, education, government service, industry, and commerce.

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