

**International Ethics Standards Board for Accountants (IESBA)  
CONSULTATIVE ADVISORY GROUP (CAG)**

**Draft Minutes**

**Held on September 13, 2010 London, United Kingdom**

<i>Present:</i>	Richard Fleck (chair)	Financial Reporting Council
	Marc Picqueur	Basel Committee on Banking Supervision
	Kristian Koktvedgaard	Business Europe
	Federico Diomeda	European Federation of Accountants and Auditors for SMEs
	Marie Lang	European Federation of Accountants and Auditors for SMEs
	Philip Johnson	Fédération des Experts Comptables Européens
	Hilde Blomme	Fédération des Experts Comptables Européens
	Margie Bastolla	Institute of Internal Auditors
	Patricia Sucher	International Organization of Securities Commissions
	Koichiro Kuramochi	International Organization of Securities Commissions
	Filip Cassel	International Organization of Supreme Audit Institutions
	Gaylen Hansen	National Association of State Boards of Accountancy
	David Morris	North American Financial Executives Institutes
	Dominique Pannier	Organisation for Economic Cooperation and Development
	Martin Baumann	Public Company Accounting Oversight Board <sup>1</sup>
	Ajith Ratnayake	Sri Lanka Accounting and Auditing Standards Monitoring Board
	Simon Bradbury	World Bank
	Linda de Beer	World Federation of Exchanges
	Ken Dakdduk	IESBA Chair
	Michael Niehues	IESBA Deputy Chair
	James Gaa	IESBA Member
	Robert Franchini	IESBA Member
	Isabelle Sapet	IESBA Member
	Brian Walsh	IESBA Member
	Jan Munro	IESBA Deputy Director
	Jim Sylph	IFAC Executive Director, Professional Standards

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<sup>1</sup> The views expressed by Mr. Baumann, here noted in the minutes, represent his own and do not necessarily reflect the views of the PCAOB Board or PCAOB Board members or its staff.

	Gonzalo Ramos	PIOB
<i>Regrets</i>	Conchita Manabat	Asian Financial Executives Institutes
	David Damant	IAASB Consultative Advisory Group and CFA Institute
	Matthew Waldron	CFA Institute
	Elena Lobanova	Graduate School of Financial Management, Russia
	Gerald Edwards	Basel Committee on Banking Supervision
	Georges Couvois	European Federation of Financial Executives' Institutes
	Jean-Luc Peyret	European Federation of Financial Executives' Institutes
	Paul Koster	Gulf States Regulatory Authorities
	Obaid Saif Hamad Al Zaabi	Gulf States Regulatory Authorities
	Susan Koski-Grafer	International Organization of Securities Commissions
	John Carchrae	World Bank

### **A. Opening Remarks**

Mr. Fleck welcomed all participants to the CAG meeting. He also welcomed as new representatives Mr. Hansen, representing National Association of State Boards of Accountancy; Mr. Kuramochi representing the International Organization of Securities Commissions and Mr. Pannier from the Organisation for Economic Cooperation and Development.

The minutes of the Barcelona March 2010 CAG meeting were approved subject to some editorial changes.

### **B. Report from IESBA Chair**

Mr. Dakdduk reported that the IESBA had met once since the last CAG meeting. The IESBA met in June 2010 in Paris, France. At that meeting, in addition to standard setting activities, the IESBA discussed its convergence initiative. As a first step in pursuing its convergence objective, at its June 2010 meeting, the IESBA discussed a first draft of a document that isolates the independence provisions of the Code that an auditor of a public interest entity would be required to comply with. The second step would be to use the document to facilitate a benchmarking exercise to help the IESBA determine how key provisions in the Code compare to those of other jurisdictions. The Board will consider the results of that comparison to determine whether it should readdress a Code provision for the purpose of reducing or eliminating a difference between that provision and the comparable provision of other jurisdictions. The third step would be greater undertaking outreach and engaging in additional dialogue with stakeholders. Mr. Dakdduk noted that

he felt that this third stage would be a very important part of the process because there would likely be differences of opinion as to whether some differences should be eliminated. While it would not be feasible to eliminate all differences it was important to understand why the differences existed.

Mr. Dakdduk noted that many respondents to the exposure draft of the Strategy and Work Plan had indicated that IESBA should give a priority to adoption and implementation activities. In this regard, there were three additional activities that had been started. Some staff questions and answers were under development. These questions and answers, which will not be authoritative, would provide some practical guidance on implementation of the Code. It was expected the questions and answers would be issued in October. A second initiative related to increasing outreach and presentations. He noted that members of the Board had made presentations in Europe and more were planned in the next quarter. The third initiative related to a research project that the Planning Committee would recommend to the IESBA to better understand the needs of SMEs and SMPs

### **C. Responding to Suspected Fraud and Illegal Acts**

Mr. Franchini, Task Force chair, introduced the topic. He noted that at the Barcelona meeting, CAG members discussed a draft project proposal addressing how a professional accountant should respond when encountering a suspected fraud or illegal act. At that meeting, CAG members expressed support for the IESBA commencing such a project and provided some comments on the scope of the project. Respondents to the IESBA's strategic survey also rated this project as a high priority. The Task Force met in early July, considered the comments from CAG members, and revised the draft project proposal. The project proposal will be presented to the IESBA at its November 2010 meeting for approval.

Mr. Franchini noted that confidentiality is a fundamental principle in the Code. The principle requires professional accountants to “to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties.” The Code identifies three circumstances where professional accountants are required, or may be required, to disclose confidential information:

- Disclosure is permitted by law and is authorized by the client or the employer;
- Disclosure is required by law; and
- There is a professional duty or right to disclosure when not prohibited by law.

The Code does not contain any guidance on situations when there is a profession duty or right to disclose confidential information when not prohibited by law. The goal of the project is to provide guidance for professional accountants on how to respond in situations where they encounter a suspected fraud or illegal act.

Mr. Franchini noted that many jurisdictions have “whistle blowing” legislation, some of which is quite extensive. The Task Force will look at the principles contained in such legislation and see whether it can leverage off such principles. The project will not attempt to catalogue such legislation.

*Right or Duty to Report*

The Task force had carefully considered the input from CAG members at the March 2010 meeting on the subject of whether the professional accountants should have a duty, in some circumstances, to breach confidentiality and report suspected frauds or illegal acts or whether there Code should enable such reporting by providing the accountant with a right to report such matters. Mr. Franchini reported that the Task Force’s preliminary thinking in this area was that an appropriate approach might be to establish a rebuttable presumption to report. This might strike the appropriate balance for a global standard because factors to be considered in determining whether a matter should be reported included whether action would be taken and also legal protections afforded the whistleblower.

Mr. Fleck noted that if the rebuttable nature of the requirement was that the professional accountant would report outside of the organization unless by reporting the professional accountants would open themselves up to a charge under law, this would reach the same position as a duty to report unless prohibited by law. Mr. Franchini responded that the early thinking of the Task Force was that if there was a requirement in the law to report the professional accountant would do so. If there was not a legal requirement, the professional accountant would then consider impact on the public interest and would also consider any legal protections available.

Ms. Sucher stated that she would be concerned if the duty to report was couched in terms of a rebuttable presumption. As a regulator, she felt that it would be clearer if the requirement was stated in terms of a duty to report except in certain specified circumstances. Such an approach was preferable given the inherent tensions and self-interest.

Mr. Franchini responded, noting that the current Code appears to preclude reporting by putting the principle of confidentiality ahead of the public interest. The Task Force’s current view was that this was not right and the public interest should be put ahead of confidentiality.

Mr. Pannier stated that the OECD convention on combating bribery might be useful to the Task Force and encouraged the Task Force to consider this convention which had been adopted in law in many jurisdictions. Mr. Franchini thanked Mr. Pannier and indicated that the Task Force was in contact with the OECD {?} and the Task Force would review the document identified by Mr. Pannier.

Mr. Hansen stated that he would find it difficult to imagine a fact pattern where there was not a duty to report a suspected fraud or illegal act. He also noted that it was very important to consider the linkage to report to those charged with governance. Mr.

Franchini agreed that it was important to consider reporting to those charged with governance and the Task Force was carefully considering the existing requirements in this area in the ISAs. Ms Sucher asked whether there would be co-ordination with the IAASB. Mr. Franchini stated that there would be co-ordination with the IAASB.

Mr. Diomeda stated that in looking at the issue of a duty or a right to report, because integrity is a fundamental principle in the Code, it could be argued that the duty to report a suspected fraud or illegal act already exists. Integrity imposes an obligation, or duty to be straightforward and honest on all professional and business relationships.

Mr. Franchini noted that the project would address all professional accountants, those in public practice and those in business; the extent of the duty to report might be different.

Mr. Kuramochi indicated that the definition of the public interest would be important. Mr. Sylph reported that IFAC was developing a document that will discuss the meaning of the public interest. The document was being developed by the IFAC Board and would outline criteria that, in the IFAC Board's view, would be considered by people when discussing the public interest. While the public interest criteria would be the application of the criteria would be different depending upon whether one was a shareholder, a lender etc. He indicated that the document would be issued for comment for a 90-day comment period and urged CAG members to encourage their organizations to respond to the exposure draft.

Mr. Kuramochi asked whether the Task Force had considered the paper. Mr. Franchini responded that the Task Force would consider the paper when it was issued.

Mr. Fleck noted that a concern with a rebuttable presumption approach would be if one of the factors that entered the consideration is the impact on the relationship between the auditor and the client. Mr. Franchini agreed and emphasized that it was not the intention of the Task Force for such a factor to enter into the consideration. The view was that a rebuttable presumption approach might be appropriate because in certain situations flexibility might be important – for example in situations where the markets are not well developed, there is not protection for the whistle blower and the reporting would not be effective because of the lack of any enforcement regime to take action after the matter had been reported.

Mr. Hansen stated that he agreed with the putting the public interest before the principle of confidentiality. He noted that regulators often do not place as much emphasis on confidentiality and consequently an accountant might think that he or she has more protection than really exists.

#### *Role of Professional Accountant*

Mr. Franchini noted the Task Force will consider whether the role of the professional accountant has an impact on the expectations that the professional accountant will report outside of the entity. The Task Force will consider matters such as the seniority of the individual, his or her role within the organization, the nature of the professional service

provided, and the proximity of the professional service to the suspected fraud or illegal act.

#### *Types of Matters to be Addressed*

The task force is considering the types of confidential matters that the professional accountant may need to disclose as a result of a suspected fraud or illegal act. In defining these matters, the IESBA will be mindful of the definition of fraud contained in ISA 240 (“intentional acts ... involving the use of deception to obtain an unjust or illegal advantage”) and the definition of illegal acts contained in ISA 250 (“acts of commission or commission by the entity which are contrary to prevailing laws and regulations”). The initial presumption will be to restrict the matters to be addressed to suspected fraud or illegal acts, the IESBA will consider whether, however, the scope of the project should be wider and address, for example, matters that are “unethical” or “improper.”

Mr. Johnson noted that there seemed to be a focus on professional accountants in practice and it was important that professional accountants in business were also appropriately considered. Mr. Franchini responded that the project would be addressing both types of accountants and there will be a need to have considerable discussion about professional accountants in business. Indeed the Task Force will be mindful of whether the project should be split into two separate work streams to address each category.

Ms. Bastolla noted that many internal auditors are involved in fraud investigations and that there is an expectation that if a fraud is reported to the internal audit function it will be addressed and investigated throughout the organization.

Mr. Morris noted that there was a difference between internal auditors and other professional accountants within the organization. While he supported the notion that there should be an obligation to report a suspected fraud or illegal acts it would be more difficult for an accountant within the organization to fulfill this obligation than it would be for an internal auditor.

Mr. Baumann noted that there was a mistake in the slides and the reference should be to “omission or commission” as opposed to “commission or commission”. Mr. Franchini thanked Mr. Baumann for this point.

#### *Threshold for Taking Action*

The project will consider what guidance can be provided to a professional accountant regarding the threshold for taking action. This will include a consideration of the level of suspicion, recognizing that the final determination is ultimately a legal issue and likely there would be differing levels of suspicion. The threshold will also consider the likely effect or magnitude of the suspected fraud of illegal act.

#### *Other Matters*

Mr. Franchini noted that the Task Force had updated the project timetable to reflect that proposed change in approach. Ms. Sucher asked Mr. Franchini to explain the thought process behind the consultation paper. Mr. Franchini responded that the thinking had

initially had been that a consultation paper would be appropriate to obtain views on whether options were effective and operational.

Mr. Johnson asked whether in looking at the legislative environment consideration would be given to corruption and well as fraud. He noted that some of the high profile cases have come under the umbrella of the foreign corrupt practices acts and there have been cases where the US Securities and Exchange Commission had taken action in jurisdictions other than the US because of this act. Mr. Franchini responded that this matter would fall within the suspected illegal acts part of the project.

Mr. Fleck noted that it was important that the guidance clearly distinguishes between (a) the importance of reporting up through the organization irrespective of whether the professional accountant was in business or was an auditor, and (b) the consideration of the public interest only arises when reporting outside of the organization. He noted that it might be helpful if the guidance first stated the responsibilities that applied to all professional accountants and then there were additional responsibilities for auditors. Mr. Franchini responded that the Task Force would consider this matter. He noted that differing legislative environments would make it challenging. It was his understanding that there were, for example, different ways in which money laundering legislation had been enacted, and in one jurisdiction is a professional accountant in public practice is engaged to assist a company address money laundering issues, legislation in that jurisdiction delays the accountants duty to report outside of the organization, to provide a period of time for the accountant to assist the organization. The Task Force would, therefore, have to be careful not to write requirements that would override legislation.

Ms. Lang noted that careful consideration should be given to the duty for professional accountants in an SME environment because the perpetrator of the fraud or illegal act could be accountant's superior.

Mr. Kuramochi noted that the timetable called for issuance of an exposure draft in 2011 which might be before finalization of the public interest definition as would be presented in the document under the development of the IFAC Board. He noted that with a 90 day comment period for the IFAC Board document IOSCO would hope to comment on that document. Mr. Sylph responded noting that the Public Interest Activity Committees of IFAC, including the IESBA, had been developing standards that are in the public interest. He commented that while February 2011 was the target of the IFAC Board for finalization of its document attaining that target would depend on the nature of the comments that would be received on exposure. He further noted that the document was a high level document and the IFAC Board is of the view that "investor protection" is not the public interest from the broader perspective of all professional accountants. Mr. Fleck agreed noting that in relation to a breach of banking laws, the public interest could be seen as protection of depositors, in the case of corruption of a public official, the public interest could be seen as protection of the procurement process and in the case of money laundering it would be protection against terrorism.

Mr. Kuramochi noted that it was important that the Task Force carefully research laws and regulations addressing money laundering. Mr. Fleck responded that the project would develop principles that determine how a professional accountant was to react in a particular situation. Mr. Franchini noted that the thinking was to see what could be learnt from the regulations. He noted that even with the same money laundering requirements, as in the EU, the requirements could be implemented in different ways depending upon the jurisdiction.

Mr. Fleck noted that this was an important project and asked CAG members for any additional views on whether the scope of the project seemed to cover all key aspects of the project that should be addressed.

Mr. Bradbury noted that in the aftermath of the financial crisis it might be important to consider interpretation of accounting standards and the professional accountant's response if he or she did not agree with the proposed interpretation. He indicated that if this matter was not addressed in the project it might increase the expectations gap. Mr. Fleck indicated that it might be useful if the Task force gave consideration to whether this matter should be explicitly included or excluded from the project.

Mr. Baumann noted that, without seeing an exposure draft, it was difficult to answer Mr. Fleck's question as to whether the scope of the project seemed to cover all key aspects of the project that should be addressed. He noted, for example, CAG members had not been provided with criteria for the rebuttable presumption.

Mr. Morris stated that it was important that the project give careful consideration to professional accountants who provide professional services other than audit – for example taxation services where the confidentiality considerations might be different.

Mr. Hansen noted that accountants are trained to consider fraud to be fraud and the project therefore, needs to be broad, though financial reporting has to be at its core.

Mr. Franchini thanked CAG members for their comments and indicated the comments would be carefully considered by the Task Force as it developed material for the consideration of the IESBA.

#### **D. Strategy and Work Plan 2010-2012**

Mr. Dakdduk introduced the topic. The IESBA met by conference call on March 23, 2010 to discuss the comments made by CAG members at its March 2010 meeting and changes that had been made to address those comments. The IESBA approved the exposure draft of the Plan and it was released in late March with a comment period that ended on June 15, 2010. The Planning Committee had started its discussion of the 37 comment letters received.

#### *Overview of Comments Received*

Mr. Dakdduk provided an overview of the comments received. The exposure draft proposed a period of stability during which no new independence standards would be

issued and take effect. Ten respondents explicitly welcomed the board's intent to provide this period of stability and three respondents expressed the view that the period of stability should extend to all ethics projects as opposed to only independence. The respondents were generally supportive in regards to the standard setting projects but views were missed with respect to the proposed project addressing the application of the related entity definition in the audit of collective investment vehicles. Respondents were also generally supportive of the IESBA's expressed intent regarding both adoption and implementation support and convergence.

#### *Standard Setting Activities*

In relation to the standard setting project on the accountant's responsibility when encountering a suspected fraud or illegal act, the majority of respondents were supportive of this project. Some respondents commented that while they supported the project, it should result in practical guidance and should not produce any additional requirements. Two respondents expressed concern with the project, noting that local laws often control the accountant's behavior in this area and it may be difficult to develop additional meaningful global guidance. Mr. Dakdduk noted that all of the comments received on this project would be carefully considered by the Task Force as it develops its recommendations.

In relation to the standard setting project on conflicts of interest, the majority of respondents were supportive of this project. Some respondents commented that while they supported the project, it should result in practical guidance and should not produce any additional requirements. Other respondents noted that business, commercial and legal conflicts differ from auditor independence, the project encompasses conflicts with the accountant's public interest duty and it should also consider the unique environments of the SMP and SMEs. Mr. Dakdduk noted that all of the comments received on this project would be carefully considered by the Task Force as it develops its recommendations.

In relation to the standard setting project related to the application of the related entity definition in the audit of collective investment vehicles, eight respondents expressed concern with the priority of this project. Some respondents noted that the way such vehicles are structured differs significantly between jurisdictions and, therefore, a global standard would be difficult to develop and complex to apply. Some respondents expressed support for the project, with two respondents stating that it should start as soon as possible. Mr. Dakdduk noted that the Planning Committee had carefully considered the comments received and were persuaded that in light of the significant differences in the structure of such vehicles, it would be problematic to develop practical guidance that was globally applicable. The Planning Committee, therefore, intended to recommend that, in light of other priorities identified, this project be deleted from the IESBA's work program.

Ms. de Beer noted that there had been a compelling case for including the project on the proposed work plan and care should be taken to ensure that it was not removed from the program merely because the project seemed to be difficult and asked whether more research should be conducted in this area before the project was removed. Mr. Dakdduk

agreed that an option would be to conduct additional research and, in light of the research, consider whether it would be useful to issue additional for example in the form of a staff document.

Mr. Kuramochi noted the structure of these vehicles may differ from jurisdiction to jurisdiction and that some IOSCO members felt that this was an important project for which more research should be conducted. Mr. Dakdduk responded that a concern of the Planning Committee was that because of the significant differences it would not be possible to develop practical, useful guidance. Mr. Koktvedgaard noted that while the project might be an interesting one there are other projects that should be treated a higher priority. In light of the limited resources of the IESBA he supported the Planning Committee's proposal to remove this project from the planning plan.

Ms. Sucher noted that while IOSCO had expressed support for the collective investment vehicles project in its response to the Strategy and Work Plan, it had not specifically considered whether it should be a priority project.

#### *Adoption and Implementation*

Respondents expressed strong support for this initiative and were of the view that this should be an important priority of IESBA with some stating that it should take first priority over everything else. Mr. Dakdduk noted that a staff letter to member bodies had recently been posted on the IFAC membership intranet. The letter reminds readers of the upcoming effective date of the Code and the adoption and implementation support material which is already available on the website. Some staff questions and answers concerning various provisions in the Code are also under development. The questions and answers, which will not be authoritative and would not amend or override the Code, will be issued next month. In addition, the IESBA has been undertaking and will continue to undertake outreach to member bodies and other interested parties.

Mr. Pannier noted that liaison with the IFAC Compliance Advisory Panel (CAP) would be an important part of the IESBA's adoption and implementation initiative. Mr. Dakdduk agreed, noting that there was close liaison with the CAP and the IESBA had received a presentation from the CAP at its February 2010 meeting.

#### *Convergence*

Respondents also expressed strong support for this initiative. The Planning Committee is developing a series of convergence initiatives which it will incorporate into the strategic plan which would include outreach activities. Mr. Pickeur asked whether regulators would be included in the outreach. Mr. Dakdduk responded that some such outreach had already taken place and more was planned. He noted that the IESBA saw the adoption and implementation initiative as separate from, but clearly linked to, the convergence initiative.

Mr. Dakdduk stated that, as part of its convergence initiatives, IESBA will continue to seek input on the types of improvements to the Code that national standard setters and regulators believe should be made in order for the Code to gain acceptance and

recognition in their jurisdiction. The Planning Committee has considered comments received regarding the provisions in the Code addressing an inadvertent violation. After considering those Code provisions, the Planning Committee intends to recommend at the November IESBA meeting that the IESBA commence a project to address this area (this matter was discussed in more detail under Agenda Item F).

Mr. Koktvedgaard indicated that it was very important that the outreach include audit regulators because these bodies have great influence over the profession. He expressed the opinion that there was a risk that these regulators might push audit, ethical and independence matters to more of a rules and check-list approach as opposed to emphasizing principles. Mr. Dakdduk noted that as part of its convergence and outreach activities, the IESBA would emphasize the strengths and benefits afforded by the conceptual framework approach.

#### *SMPs and SMEs*

Mr. Dakdduk reported that many respondents had indicated the importance of placing greater focus on the needs of small and medium-size entities and firms. In responding to these concerns, the Planning Committee would be recommending to the IESBA that a working group be formed to examine this issue. The working group would be chaired by a member of the IESBA and would include some IESBA representation and significant representation by the SME and SMP community.

Mr. Casel expressed support for this approach and noted that recent studies had indicated that there are issues that are unique to this community.

Mr. Diomeda stated that this was a very important matter and because it was not always easy to identify SME/SMP issues it was a good idea to establish a working group that would focus solely on these issues. He further noted that the European Federation of Accountants and Auditors for SMEs would be pleased to provide assistance in this area.

Mr. Fleck reflected on the APB process when adopting the ISAs and noted that the APB formed a committee to consider SMP issued. The approach had been successful and facilitated the adoption of the revised and clarified ISAs.

#### *Other Comments and Issues*

Mr. Dakdduk provided an overview of other comments received on the plan. There was some support for raising the priority of two projects - namely (a) ethical guidance for professional accountants performing non-assurance services for non-assurance clients and (b) independence requirements for professional accountants who are not in public practice who perform assurance engagements. The Planning Committee had considered the comments on these matters and will be considering the types of matters that might be addressed in a project providing ethical guidance for professional accountants providing non-assurance services to non-assurance clients. The Planning Committee is of the view that this additional consideration is necessary for it to form an opinion as to whether it should recommend to the IESBA that such a project be added to the IESBA's next work plan.

Mr. Dakdduk thanked CAG members for their comments and indicated that they would be carefully considered by the Planning Committee as it continued to consider the responses to the Strategy and Work Plan. The planning Committee will present a revised Strategy and Work Plan to the IESBA at its November 2010 meeting for approval.

### **E. Firm Reputational Risk**

Mr. Fleck introduced the topic noting that at the March 2010 meeting, during the discussion of the potential IESBA project to provide ethical guidance for professional accountants who provide non-assurance services, the issue of firm reputation risk arose. The Code addresses the activities of auditors and audit teams but it does not address the activities of business units within accounting firms. He noted that the public standing of financial reporting and assurance could be affected by indirect factors such as the level of non-audit services and fees and tax advice and tax products provided by the firm. In this regard an overall question to be considered what whether the IESBA should consider principles or standards to be observed by firms (as opposed to individual accountants) to protect and enhance the reputation for integrity and professionalism.

In considering this overall question, CAG members might wish to consider three specific questions.

- What activities are undertaken by accountancy firms that carry an independent risk to the firm's reputation, for example, taxation services, accountancy services, legal advice and corporate finance advice?
- Because those activities are invariably also carried out by individuals and organization other than accountancy firm, what are the considerations affecting whether IESBA should provide principles or standards addressing these matters? For example, the effect on a firm's ability to compete, the likelihood that any established principles and standards would achieve general acceptance and the ability to establish leadership in good practice.
- If the view is that it would be inappropriate or impractical to address this issue in the Code, should it be addressed in another way, or is it already addressed in another way? For example, the IAABS addresses firms through ISQC1, could the IESBA approach issue by requiring the individual accountant to consider, as a specific responsibility matters such as whether a product or service would risk adversely affecting the standing of a firm's reputation or a firm's reputation when performing any managerial or supervising function/role. Also could guidance be provided through guidance in respect of general principles such as integrity?

Mr. Diomeda expressed the view that the matter is linked to the principle of professional competence and due care. He also noted that in many Anglo-Saxon jurisdictions where the professional accountant exists because of the professional associations the matter could be addressed through principles in the Code. In other jurisdictions, however, where the professional accountant is enshrined in law, it is the law that will determine what is appropriate. With respect to the question of ability of firms to compete, he noted that there was a balance between competition and professional competence.

Mr. Fleck stated that part of the issue was the type of services that an accounting firm would aspire to provide. For example, in the area of tax, some might feel it appropriate to offer taxation services that were particularly aggressive. He questioned whether if firms offered such services that were too close to the line there was a risk that the firm's reputation would be damaged and this would damage the reputation of the profession and ultimately undermine the confidence in the audit.

Mr. Baumann stated that, in the US, there had been a risk that one of the big firms could have ceased operations because of aggressive tax services. He questioned whether addressing the issue as outlined by Mr. Fleck was within the remit of the IESBA and, if so, what the enforcement mechanism would be. Mr. Fleck noted that this was an important issue and stated that if CAG members felt that this was an important issue perhaps it should raise the issue with IESBA or IFAC to see how it could be addressed. Mr. Baumann noted that, in the US, the GAO had undertaken a number of projects to look at the sustainability of accounting firms and, perhaps, a study on this matter could be undertaken.

Ms. Sucher noted that she had been interested in this subject at the discussion at the previous CAG meeting but perhaps it would be useful to step back and consider the public interest perspective. She noted that the requirement to have a statutory audit was something that was imbedded in law or regulation and therefore this would be a matter in which IOSCO would be interested. It would be a concern to IOSCO is an audit firm was undertaking non-assurance service which could bring into question the quality of the audit.

Mr. Kuramochi expressed the view that it could be said that the start of the public interest was when assurance services were provided to third party users. It could, therefore, be argued that if a firm also wished to provide non-assurance services, these services should be provided under another brand or trade mark. However, such an approach was problematic because some of the non-assurance services were integral to the audit and needed to be provided with the audit. In this regard, perhaps the issue related more to the corporate governance of the audit firm.

Mr. Hansen stated that in the US, the matter is addressed through quality control standards that have been adopted for audit services and perhaps a solution would be to extend such quality control standards to all services.

Mr. de Beer agreed with Mr. Kuramochi, noting that if one looked at the topics on the IAASB agenda it is possible to see the linkage and therefore perhaps some of the answers rested in IAASB material.

Mr. Pickeur noted that the topic was both interesting and intriguing. He noted that a similar issue had been addressed in the banking sphere through the formation of banking compliance functions. He noted that while it was not possible to define reputational risk,

the approach taken had been to require the banks to establish a corporate policy to explain the extent to which management was prepared to accept risk.

Mr. Fleck noted that there were different ways to address the issue: through quality control standards; through an equivalent to a compliance function; or through the corporate governance structures of the accounting firms. He noted that any of these alternatives raised the question of whether it would be within the remit of IESBA or within the remit of IFAC.

Mr. Pickeur stated that he thought it probably lay within the corporate governance structure.

Mr. Johnson stated that reputational risk was an important issue and with some jurisdictions the only part of a professional services firm that was regulated was the audit side. He noted that the tone at the top was important because if there was a problem in any part of the professional services firm this could have negative impact on the audit brand as evidenced by the issues created by the aggressive tax services provided in the US. It was, however, important not to confuse the matter with the provision of non-assurance services because if a firm provides audit services to 15% of the market that meant that there was 85% of the market to which the firm could provide any non-assurance services. He also noted that it might be difficult to find the right “hook” such that this matter could be addressed by IESBA or another body under IFAC.

Mr. Ratnayake agreed that the matter should be addressed. He noted that the term “reputational risk” sounded somewhat like “self-interest” risk and perhaps the phrase “public interest responsibility” sounded less self-interested.

Mr. Koktvedgaard stated that it was an issue of internal control and risk management. In Europe the transparency reports for firms auditing public interest entities addresses this issue. Mr. Johnson noted that while the transparency reports addressed the issue of tone at the top it did not completely address the issue of reputational risk.

Mr. Morris noted that as a preparer he was initially hesitant about the new banking regulation but it was a very positive development.

Mr. Baumann noted that the legal structures of accountancy firms would make this a challenging issue to address because often firms were structured with audit in one firm and the consulting practice in another. Mr. Fleck agreed and noted that a starting point was to ensure that those who were providing such services within the firms were doing so appropriately even if they were not professional accountants.

Mr. Fleck asked whether this was a matter that could be addressed by IESBA. Ms. Munro noted that the fundamental principle of professional behavior required professional accountants to comply with relevant laws and regulations and avoid any action that discredits the profession. Mr. Sylph indicated that CAG members might want to consider whether this matter would sit in the overall priority of matters facing IESBA. Mr. Fleck

noted if CAG members felt that it was a matter that should be addressed, they could then consider whether it was something IESBA could consider or whether there was another body within IFAC that could consider it. Mr. Sylph expressed the view that he did not think that the IFAC Board was looking to providing guidance for professional service firms.

Mr. Dakdduk stated that he saw the matter as a governance issue. He also noted that it would be important to be sensitive to a member body's ability to enforce any recommendations. He noted that the topic was a good illustration of how it would be useful if the IESBA had a vehicle other than that Code to disseminate guidance.

Mr. Johnson noted that it was challenging that the Code addresses individuals as opposed to firms and because of this perhaps the action, if any, would need to be taken at the IFAC level.

Mr. Fleck thanked CAG members for their comments. He noted that there seemed to be a view that issues were significant and could be detrimental to the profession. The challenge however, was to find a way to address the issue. He indicated that he would give some further thought to the matter and brain storm the issue with some CAG members to see if there was a way forward.

#### **F. Inadvertent Violation**

Mr. Dakdduk introduced the subject. He noted that the Code contains several paragraphs addressing an inadvertent violation of a provision in the Code. The overall provision, states that a professional accountant may inadvertently violate a provision of the Code. It indicates that, depending upon 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. Sections 290 and 291 contain a general paragraph stating 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 paragraphs also require the firm to determine whether the matter should be discussed with those charged with governance.

The IESBA Planning Committee has considered concerns that have been expressed regarding these provisions. The concerns include:

- A view that the provisions may encourage less compliance rigor; and
- Whether the meaning of inadvertent is clear.
- Whether materiality has a role in the assessment of the consequences of an inadvertent violation.

The Planning Committee is of the view that a project be commenced to reconsider the provisions in the Code addressing an inadvertent violation of the Code, including whether the Code should contain such provisions and, if so, how the provisions can best serve to protect the public interest. The Planning Committee will recommend to the IESBA, at its November meeting, that a project to address this matter be commenced.

If the conclusion is that the Code should contain such provisions it will assess the following matters:

- *Scope of Coverage* – The project will consider whether the provisions should apply to all of the Code or only to the independence provisions of the Code.
- *“Inadvertent”* –The project will consider whether “inadvertent” is the appropriate descriptor and if so whether guidance should be given on the meaning of inadvertent.
- *Consequences of a violation* – The project will consider whether there are some violations that are of such magnitude that, even if the action creating the violation was inadvertent, compliance with the fundamental principles would still be compromised.
- *Quality Control Policies and Procedures in Place* – The inadvertent provisions in the Code addressing independence require the firm to have appropriate quality control policies and procedures in place equivalent to this required by ISCQ. The project will consider whether this requirement continues to be appropriate or whether additional guidance is required.
- *Safeguards* –The project will consider whether any additional guidance should be given, including, the types of safeguards that might be appropriate.
- *Discussion with those Charged with Governance* – The project will consider whether there should be a requirement to report.
- *Implications of an Inadvertent Violation* – The project will consider the implications, for example it would be deemed to not to compromise compliance with the fundamental principles or whether the Code should indicate that, provided certain criteria are met, no enforcement action need to be taken or it would not impact the firm’s ability to issue the audit opinion.

Mr. Kuramochi noted that there seemed to be a bit of a disconnect in the Code because if there was a strong system in place there should not be any inadvertent violations and perhaps the existence of inadvertent violations is an indication that the system of internal controls is not effective.

Mr. Fleck agreed stating that it went to the heart of the meaning of inadvertent but asked what the response should be if an accountant had explicitly told a broker not to purchase shares in certain entities but the broker had disregarded the instructions and made the purchase

Mr. Baumann noted that he agreed with the project proposal and felt that this was an area that needed to be addressed as a priority. He noted that while the examples provided are often the inadvertent purchase of shares, the potential scope if much broader. He stated

that he also agreed that the matter should be addressed on a timely basis as indicated in the project plan.

Mr. Hansen questioned whether unintentional was a better descriptor than inadvertent.

Ms. Blomme noted that she had not heard any specific concerns from FEE member bodies about the provisions and was not aware of any instances where the provisions had been abused. In listening to the arguments, however, she agreed with the need to look at the provisions because the provisions seemed to be capable of misinterpretation.

Mr. Ratnayake stated that he agreed that the ISEAB should consider the matter. He noted that inadvertent violations do occur and that it was important to have clear guidance on the matter. It needs, for example, to be very clear that if an action was intentional it could not fall under the inadvertent violations provisions.

Mr. Fleck noted that the question of scope was critical and if the meaning of inadvertent is clear, the remainder of the project will fall into place more easily.

Mr. Dakdduk thanked the CAG members for their input.

#### **G. PIOB**

Mr. Fleck invited, Mr. Ramos representing the Public Interest Oversight Board (PIOB), to make some comments. Mr. Ramos thanked Mr. Fleck noting that this was the first time that he had observed the IESBA CAG and his role was to consider whether, as CAG members discussed issues, it was clear that the public interest was at the center of their consideration. He has therefore paid particular attention to whether the public interest was at the heart of the discussions. In this regard his general comment was that he was impressed how clear it was that CAG members considered the public interest in their discussions. He congratulated CAG members in this regard.

Mr. Ramos noted that he was pleased by the level of participation by IESBA CAG members.

Mr. Ramos made the following specific comments:

- He noted that he was pleased that Mr. Dakdduk had placed a lot of emphasis on adoption and implementation support noting that this was a very important matter. He also noted that he was glad to see that the IESBA was willing to consider the provisions addressing an inadvertent violation of the Code because this was an important matter to some stakeholders;
- With respect to the discussion on the project addressing the accountant's responsibility to respond to a suspected fraud and illegal act, he expressed the view that the public interest should clearly be placed ahead of the principle of confidentiality. He also noted that an accountant should have a duty to report as opposed to a right. He noted that this seemed to be consistent with the views expressed around the table;
- He looked forward to reading the IFAC paper on the Public Interest;

- The discussion on adoption and implementation had been very important because it is the development of high quality standards is only effective if the standards are adopted and implemented. In this regard, he was pleased to hear that the IESBA would be consulting with regulators;
- On reputational risk he congratulated the CAG members on their open and candid discussion and willingness to tackle new ground, and congratulated Mr. Fleck on his courage in bringing this to the foreground.

Mr. Fleck thanked Mr. Ramos for his remarks.

#### **H. Close of Meeting**

Mr. Fleck thanked all members for their attendance and closed the meeting.

Future Meetings:

- March 7, 2011 (New York, US)
- September 14, 2011 (Prague, Czech Republic)