



25 July 2012

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 CHANGE TO THE DEFINITION OF "THOSE CHARGED WITH GOVERNANCE"

Comments to be received by 28 September 2012

The Hong Kong Institute of Certified Public Accountants' (Institute) Ethics Committee is seeking comments on the IFAC's IESBA Exposure Draft on Proposed Change to the Definition of "Those Charged with Governance" which has been posted on the Institute's website at:

www.hkicpa.org.hk/professionaltechnical/ethics/exposedraft/.

The Explanatory Memorandum to the Exposure Draft provides background information and explanation of, the proposed change to the definition of "those charged with governance" in the IESBA *Code of Ethics for Professional Accountants* (IESBA Code). The objectives of the change are to more closely align the definition of "those charged with governance" in the IESBA Code with that in the International Auditing and Assurance Standards Board's International Standard on Auditing 260, *Communication with Those Charged with Governance*, and to eliminate any confusion as to how it is defined. The IESBA is of the opinion that the proposals do not call for any change in systems or common practice, should they be approved.

The change specifically aims to clarify that a subgroup, such as an audit committee, may assist the governing body in meeting its responsibilities. In those cases, the auditor shall determine with whom within the entity's governance structure to communicate.

The IESBA proposes that the change be effective one year after approval of the final change to the IESBA Code. Subject to comments received on exposure, the IESBA expects to finalize the revision to the IESBA Code in the second half of 2012.

The IESBA welcomes comments on all matters addressed in the Exposure Draft. In particular, it would be helpful if respondents' comments could include the areas set out in the guide for respondents which are in page 6 of the IESBA Exposure Draft.

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

Standard Setting Department
Hong Kong Institute of Certified Public Accountants
37/F., Wu Chung House
213 Queen's Road East
Hong Kong

Fax number (+852) 2865 6776
E-mail: commentletters@hkicpa.org.hk

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

25 July 2012
Exposure Draft

Response Due Date
28 September 2012

ED of Proposed Change to the Code of Ethics

Proposed Change to the Definition of "Those Charged with Governance"



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

CONTENTS

ED of Proposed Change to the Definition of "Those Charged with Governance"

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:
www.hkicpa.org.hk/professionaltechnical/ethics/exposedraft/.

Exposure Draft

July 2012

Comments due: October 31, 2012

*International Ethics Standards Board for
Accountants*

Proposed Change to the Definition of “Those Charged with Governance”

IESBA

International
Ethics Standards
Board for Accountants

This Exposure Draft was developed and approved by the International Ethics Standards Board for Accountants (IESBA).

The IESBA is an independent standard-setting board that develops and issues 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 objective of the IESBA is to serve the public interest by setting high-quality ethical standards for professional accountants and by facilitating the convergence of international and national ethical standards, including auditor independence requirements, through the development of a robust, internationally appropriate code of ethics.

The structures and processes that support the operations of the IESBA are facilitated by the International Federation of Accountants (IFAC).

Copyright © July 2012 by the International Federation of Accountants (IFAC). For copyright, trademark, and permissions information, please see [page 18](#).

REQUEST FOR COMMENTS

This Exposure Draft, *Proposed Change to the Definition of “Those Charged with Governance,”* was developed and approved by the International Ethics Standards Board for Accountants (IESBA).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by October 31, 2012.**

Respondents are asked to submit their comments electronically through the IESBA website, using the “[Submit a Comment](#)” link. Please submit comments in both a PDF and Word file. Also, 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 website. Although IESBA prefers that comments are submitted via its website, comments can also be sent to Jan Munro, IESBA Technical Director at janmunro@ethicsboard.org.

This publication may be downloaded free of charge from the IESBA website: www.ethicsboard.org. The approved text is published in the English language.

CONTENTS

	Page
Explanatory Memorandum.....	5
Exposure Draft: Proposed Change to the Definition of "Those Charged with Governance"	7

EXPLANATORY MEMORANDUM

Introduction

This memorandum provides background for, and an explanation of, the proposed change to the definition of “those charged with governance” in the IESBA *Code of Ethics for Professional Accountants* (the Code). The International Ethics Standards Board for Accountants (IESBA) approved these proposed changes in June 2012 for exposure.

Background

At its February 2012 meeting, the IESBA discussed responses to the Exposure Draft “Proposed Changes to the Code of Ethics for Professional Accountants Related to Provisions Addressing a Breach of a Requirement of the Code.” A respondent noted that the Code's definition of “those charged with governance” is not consistent with the definition in International Standard on Auditing 260 (ISA 260), *Communication with Those Charged with Governance*. The IESBA considered the definition in ISA 260 and concluded that the communications required under the Code should be to the same group of people as the communications under ISA 260. The IESBA, therefore, agreed that a project should be undertaken to more closely align the Code's definition of “those charged with governance” with the definition contained in the ISA.

Significant Matters Considered

ISA 260 deals with the auditor's responsibility to communicate with those charged with governance. It addresses matters to be communicated and provides guidance on who should receive the communication. The IESBA proposes to amend the definition in the Code of “those charged with governance” to more closely align with the definition in ISA 260. The revised definition captures essentially the same group of persons as captured by the current definition (see page 7) but the proposed change will enhance its clarity and its consistency with the definition in ISA 260. This proposal also recognizes, as does the definition in ISA 260, that the communication may be with a subgroup of those charged with governance.

The definition of “those charged with governance” in ISA 260 paragraph 10(a) is:

“The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager. For discussion of the diversity of governance structures, see paragraphs A1-A8.”

The IESBA proposes to amend the Code's definition to align it with the above, with the exception of the last sentence, which is specific to ISA 260.

This change will assist those who are familiar with ISA 260 by clarifying that the definition in the Code is intended to be the same as in ISA 260.

Paragraphs 11 and 12 of ISA 260 recognize that a subgroup, such as an audit committee, may assist the governing body in meeting its responsibilities. Under those paragraphs, the auditor is required to

determine with whom within the entity's governance structure to communicate. The IESBA proposes to recognize this with additional text to the Code in paragraph 290.28.

The IESBA proposes that in each instance when the Code refers to communication to "those charged with governance," the language is changed to "those charged with governance or a subgroup thereof." This change will reflect common practice by recognizing that communications with a subgroup of those charged with governance constitute communications with those charged with governance.

To assist readers of this Exposure Draft in understanding the context of the proposed changes, the change to each affected paragraph is reproduced in this Exposure Draft. In addition, the change to each affected paragraph within the entire Code is available at www.ethicsboard.org.

Analysis of the Overall Impact of the Proposed Changes

The IESBA is of the opinion that the proposals do not call for any change in systems or common practice and does not anticipate any adverse impact from the proposed changes. Clarifying that "those charged with governance" includes a subgroup thereof may have a positive impact by bringing the Code in line with ISA 260 and with practice, and eliminating confusion about how the term is defined.

Effective Date

The IESBA proposes that the change be effective one year after approval of the final change to the Code.

Project Timetable

Subject to comments received on exposure, the IESBA expects to finalize the revision to the Code in the second half of 2012.

Guidance to Respondents

The IESBA welcomes comments on all matters addressed in the Exposure Draft. Comments are most helpful when they include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed wording changes. When a respondent agrees with proposals in the Exposure Draft (especially those calling for modification in current practice), it is 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 with the proposed change to more closely align the definition of "those charged with governance" to the definition contained in ISA 260, *Communication with Those Charged with Governance*?
2. Do respondents agree that in each case as noted in the Exposure Draft, communication to "those charged with governance or a subgroup thereof" would be appropriate?

EXPOSURE DRAFT

Definition

Those charged with governance

The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

Those Charged with Governance

290.28 Even when not required by the Code, applicable auditing standards, law or regulation, regular communication is encouraged between the firm and those charged with governance of the audit client or a subgroup thereof regarding relationships and other matters that might, in the firm's opinion, reasonably bear on independence. Such communication enables those charged with governance or a subgroup thereof to:

- (a) consider the firm's judgments in identifying and evaluating threats to independence,
- (b) consider the appropriateness of safeguards applied to eliminate them or reduce them to an acceptable level, and
- (c) take appropriate action.

Such an approach can be particularly helpful with respect to intimidation and familiarity threats.

In complying with requirements in this section to communicate with those charged with governance, the firm shall determine the appropriate person(s) within the entity's governance structure with whom to communicate. If the firm communicates with a subgroup of those charged with governance, for example an audit committee, or an individual, the firm shall determine whether communication with all of those charged with governance is also necessary so that they are adequately informed.

100.19 Where a matter involves a conflict with, or within, an organization, a professional accountant shall determine whether to consult with those charged with governance of the organization, or a subgroup thereof ~~such as the board of directors or the audit committee.~~

200.13 Examples of engagement-specific safeguards in the work environment include:

- Having a professional accountant who was not involved with the non-assurance service review the non-assurance work performed or otherwise advise as necessary.
- Having a professional accountant who was not a member of the assurance team review the assurance work performed or otherwise advise as necessary.
- Consulting an independent third party, such as a committee of independent directors, a professional regulatory body or another professional accountant.
- Discussing ethical issues with those charged with governance of the client, or a subgroup thereof.

- Disclosing to those charged with governance of the client, or a subgroup thereof the nature of services provided and extent of fees charged.
- Involving another firm to perform or re-perform part of the engagement.
- Rotating senior assurance team personnel.

210.14 A professional accountant in public practice will generally need to obtain the client's permission, preferably in writing, to initiate discussion with an existing accountant. Once that permission is obtained, the existing accountant shall comply with relevant legal and other regulations governing such requests. Where the existing accountant provides information, it shall be provided honestly and unambiguously. If the proposed accountant is unable to communicate with the existing accountant, the proposed accountant shall take reasonable steps to obtain information about any possible threats by other means, such as through inquiries of third parties or background investigations of senior management, or those charged with governance of the client, or a subgroup thereof.

280.4 A professional accountant in public practice shall evaluate the significance of any threats and apply safeguards when necessary to eliminate them or reduce them to an acceptable level. Examples of such safeguards include:

- Withdrawing from the engagement team.
- Supervisory procedures.
- Terminating the financial or business relationship giving rise to the threat.
- Discussing the issue with higher levels of management within the firm.
- Discussing the issue with those charged with governance of the client, or a subgroup thereof.

290.34 The firm shall take steps necessary to terminate, by the effective date of the merger or acquisition, any current interests or relationships that are not permitted under this Code. However, if such a current interest or relationship cannot reasonably be terminated by the effective date of the merger or acquisition, for example, because the related entity is unable by the effective date to effect an orderly transition to another service provider of a non-assurance service provided by the firm, the firm shall evaluate the threat that is created by such interest or relationship. The more significant the threat, the more likely the firm's objectivity will be compromised and it will be unable to continue as auditor. The significance of the threat will depend upon factors such as:

- The nature and significance of the interest or relationship;
- The nature and significance of the related entity relationship (for example, whether the related entity is a subsidiary or parent); and
- The length of time until the interest or relationship can reasonably be terminated.

The firm shall discuss with those charged with governance, or a subgroup thereof, the reasons why the interest or relationship cannot reasonably be terminated by the effective date of the merger or acquisition and the evaluation of the significance of the threat.

290.35 If those charged with governance, [or a subgroup thereof](#), request the firm to continue as auditor, the firm shall do so only if:

- (a) the interest or relationship will be terminated as soon as reasonably possible and in all cases within six months of the effective date of the merger or acquisition;
- (b) any individual who has such an interest or relationship, including one that has arisen through performing a non-assurance service that would not be permitted under this section, will not be a member of the engagement team for the audit or the individual responsible for the engagement quality control review; and
- (c) appropriate transitional measures will be applied, as necessary, and discussed with those charged with governance, [or a subgroup thereof](#). Examples of transitional measures include:
 - Having a professional accountant review the audit or non-assurance work as appropriate;
 - Having a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, perform a review that is equivalent to an engagement quality control review; or
 - 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.

290.36 The firm may have completed a significant amount of work on the audit prior to the effective date of the merger or acquisition and may be able to complete the remaining audit procedures within a short period of time. In such circumstances, if those charged with governance, [or a subgroup thereof](#), request the firm to complete the audit while continuing with an interest or relationship identified in 290.33, the firm shall do so only if it:

- (a) Has evaluated the significance of the threat created by such interest or relationship and discussed the evaluation with those charged with governance, [or a subgroup thereof](#);
- (b) Complies with the requirements of paragraph 290.35(ii)–(iii); and
- (c) Ceases to be the auditor no later than the issuance of the audit report.

290.38 The professional accountant shall document any interests or relationships covered by paragraphs 290.34 and 36 that will not be terminated by the effective date of the merger or acquisition and the reasons why they will not be terminated, the transitional measures applied, the results of the discussion with those charged with governance, [or a subgroup thereof](#), and the rationale as to why the previous and current interests and relationships do not create threats that would remain so significant that objectivity would be compromised.

290.39 There may be occasions when there is an inadvertent violation of this section. If such 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 ISQCs, 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 firm shall determine whether to discuss the matter with those charged with governance, [or a subgroup thereof](#).

290.117 When an inadvertent violation of this section as it relates to a financial interest in an audit client occurs, it is deemed not to compromise independence if:

- (a) The firm has established policies and procedures that require prompt notification to the firm of any breaches resulting from the purchase, inheritance or other acquisition of a financial interest in the audit client;
- (b) The actions in paragraph 290.116 (a)–(c) are taken as applicable; and
- (c) The firm applies other safeguards when necessary to reduce any remaining threat to an acceptable level. Examples of such safeguards include:
 - Having a professional accountant review the work of the member of the audit team; or
 - Excluding the individual from any significant decision-making concerning the audit engagement.

The firm shall determine whether to discuss the matter with those charged with governance, or a subgroup thereof.

290.133 When an inadvertent violation of this section as it relates to family and personal relationships occurs, it is deemed not to compromise independence if:

- (a) The firm has established policies and procedures that require prompt notification to the firm of any breaches resulting from changes in the employment status of their immediate or close family members or other personal relationships that create threats to independence;
- (b) The inadvertent violation relates to an immediate family member of a member of the audit team becoming a director or officer of the audit client or being in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion, and the relevant professional is removed from the audit team; and
- (c) The firm applies other safeguards when necessary to reduce any remaining threat to an acceptable level. Examples of such safeguards include:
 - (i) Having a professional accountant review the work of the member of the audit team; or
 - (ii) Excluding the relevant professional from any significant decision-making concerning the engagement.

The firm shall determine whether to discuss the matter with those charged with governance, or a subgroup thereof.

290.136 If a former member of the audit team or partner of the firm has joined the audit client in such a position, and no significant connection remains between the firm and the individual, the existence and significance of any familiarity or intimidation threats will depend on factors such as:

- The position the individual has taken at the client;
- Any involvement the individual will have with the audit team;
- The length of time since the individual was a member of the audit team or partner of the firm; and

- The former position of the individual within the audit team or firm, for example, whether the individual was responsible for maintaining regular contact with the client's management or those charged with governance, [or a subgroup thereof](#).

290.141 Independence is deemed not to be compromised if, as a result of a business combination, a former key audit partner or the individual who was the firm's former Senior or Managing Partner is in a position as described in paragraphs 290.139 and 290.140, and:

- (a) The position was not taken in contemplation of the business combination;
- (b) Any benefits or payments due to the former partner from the firm have been settled in full, unless made in accordance with fixed pre-determined arrangements and any amount owed to the partner is not material to the firm;
- (c) The former partner does not continue to participate or appear to participate in the firm's business or professional activities; and
- (d) The position held by the former partner with the audit client is discussed with those charged with governance, [or a subgroup thereof](#).

290.153 The long association of other partners with an audit client that is a public interest entity creates familiarity and self-interest threats. The significance of the threats will depend on factors such as:

- How long any such partner has been associated with the audit client;
- The role, if any, of the individual on the audit team; and
- The nature, frequency and extent of the individual's interactions with the client's management or those charged with governance, [or a subgroup thereof](#).

The significance of the threats shall be evaluated and safeguards applied when necessary to eliminate the threats or reduce them to an acceptable level. Examples of such safeguards include:

- Rotating the partner off the audit team or otherwise ending the partner's association with the audit client; or
- Regular independent internal or external quality reviews of the engagement.

290.174 Accounting and bookkeeping services, which would otherwise not be permitted under this section, may be provided to audit clients in emergency or other unusual situations when it is impractical for the audit client to make other arrangements. This may be the case when (a) only the firm has the resources and necessary knowledge of the client's systems and procedures to assist the client in the timely preparation of its accounting records and financial statements, and (b) a restriction on the firm's ability to provide the services would result in significant difficulties for the client (for example, as might result from a failure to meet regulatory reporting requirements). In such situations, the following conditions shall be met:

- (a) Those who provide the services are not members of the audit team;
- (b) The services are provided for only a short period of time and are not expected to recur; and
- (c) The situation is discussed with those charged with governance, [or a subgroup thereof](#).

290.186 The preparation of calculations of current and deferred tax liabilities (or assets) for an audit client for the purpose of the preparation of accounting entries, which would otherwise not be permitted

under this section, may be provided to audit clients in emergency or other unusual situations when it is impractical for the audit client to make other arrangements. This may be the case when (a) only the firm has the resources and necessary knowledge of the client's business to assist the client in the timely preparation of its calculations of current and deferred tax liabilities (or assets), and (b) a restriction on the firm's ability to provide the services would result in significant difficulties for the client (for example, as might result from a failure to meet regulatory reporting requirements). In such situations, the following conditions shall be met:

- (a) Those who provide the services are not members of the audit team;
- (b) The services are provided for only a short period of time and are not expected to recur; and
- (c) The situation is discussed with those charged with governance, or a subgroup thereof.

290.195 The scope and objectives of internal audit activities vary widely and depend on the size and structure of the entity and the requirements of management and those charged with governance, or a subgroup thereof. Internal audit activities may include:

- (a) Monitoring of internal control – reviewing controls, monitoring their operation and recommending improvements thereto;
- (b) Examination of financial and operating information – reviewing the means used to identify, measure, classify and report financial and operating information, and specific inquiry into individual items including detailed testing of transactions, balances and procedures;
- (c) Review of the economy, efficiency and effectiveness of operating activities including non-financial activities of an entity; and
- (d) Review of compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

290.197 Examples of internal audit services that involve assuming management responsibilities include:

- (a) Setting internal audit policies or the strategic direction of internal audit activities;
- (b) Directing and taking responsibility for the actions of the entity's internal audit employees;
- (c) Deciding which recommendations resulting from internal audit activities shall be implemented;
- (d) Reporting the results of the internal audit activities to those charged with governance, or a subgroup thereof, on behalf of management;
- (e) Performing procedures that form part of the internal control, such as reviewing and approving changes to employee data access privileges;
- (f) Taking responsibility for designing, implementing and maintaining internal control; and
- (g) Performing outsourced internal audit services, comprising all or a substantial portion of the internal audit function, where the firm is responsible for determining the scope of the internal audit work and may have responsibility for one or more of the matters noted in (a)–(f).

290.198 To avoid assuming a management responsibility, the firm shall only provide internal audit services to an audit client if it is satisfied that:

- (a) The client designates an appropriate and competent resource, preferably within senior management, to be responsible at all times for internal audit activities and to acknowledge responsibility for designing, implementing, and maintaining internal control;
- (b) The client's management or those charged with governance, or a subgroup thereof, reviews, assesses and approves the scope, risk and frequency of the internal audit services;
- (c) The client's management evaluates the adequacy of the internal audit services and the findings resulting from their performance;
- (d) The client's management evaluates and determines which recommendations resulting from internal audit services to implement and manages the implementation process; and
- (e) The client's management reports to those charged with governance, or a subgroup thereof, the significant findings and recommendations resulting from the internal audit services.

290.222 Where an audit client is a public interest entity and, for two consecutive years, the total fees from the client and its related entities (subject to the considerations in paragraph 290.27) represent more than 15% of the total fees received by the firm expressing the opinion on the financial statements of the client, the firm shall disclose to those charged with governance, or a subgroup thereof, of the audit client the fact that the total of such fees represents more than 15% of the total fees received by the firm, and discuss which of the safeguards below it will apply to reduce the threat to an acceptable level, and apply the selected safeguard:

- Prior to the issuance of the audit opinion on the second year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, performs an engagement quality control review of that engagement or a professional regulatory body performs a review of that engagement that is equivalent to an engagement quality control review ("a pre-issuance review"); or
- After the audit opinion on the second year's financial statements has been issued, and before the issuance of the audit opinion on the third year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, or a professional regulatory body performs a review of the second year's audit that is equivalent to an engagement quality control review ("a post-issuance review").

When the total fees significantly exceed 15%, the firm shall determine whether the significance of the threat is such that a post-issuance review would not reduce the threat to an acceptable level and, therefore, a pre-issuance review is required. In such circumstances a pre-issuance review shall be performed.

Thereafter, when the fees continue to exceed 15% each year, the disclosure to and discussion with those charged with governance, or a subgroup thereof, shall occur and one of the above safeguards shall be applied. If the fees significantly exceed 15%, the firm shall determine whether the significance of the threat is such that a post-issuance review would not reduce the threat to an acceptable level and, therefore, a pre-issuance review is required. In such circumstances a pre-issuance review shall be performed.

291.32 If a non-assurance service was provided to the assurance client during or after the period covered by the subject matter information but before the assurance team begins to perform assurance services and the service would not be permitted during the period of the assurance engagement, the firm shall evaluate any threat to independence created by the service. If any threat is not at an acceptable level, the assurance engagement shall only be accepted if safeguards are applied to eliminate any threats or reduce them to an acceptable level. Examples of such safeguards include:

- Not including personnel who provided the non-assurance service as members of the assurance team;
- Having a professional accountant review the assurance and non-assurance work as appropriate; or
- 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.

However, if the non-assurance service has not been completed and it is not practical to complete or terminate the service before the commencement of professional services in connection with the assurance engagement, the firm shall only accept the assurance engagement if it is satisfied:

- The non-assurance service will be completed within a short period of time; or
- The client has arrangements in place to transition the service to another provider within a short period of time.

During the service period, safeguards shall be applied when necessary. In addition, the matter shall be discussed with those charged with governance, or a subgroup thereof.

291.33 There may be occasions when there is an inadvertent violation of this section. If such 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 firm shall determine whether to discuss the matter with those charged with governance, or a subgroup thereof.

291.112 When an inadvertent violation of this section as it relates to a financial interest in an assurance client occurs, it is deemed not to compromise independence if:

- (a) The firm has established policies and procedures that require prompt notification to the firm of any breaches resulting from the purchase, inheritance or other acquisition of a financial interest in the assurance client;
- (b) The actions taken in paragraph 291.111(a)–(b) are taken as applicable; and
- (c) The firm applies other safeguards when necessary to reduce any remaining threat to an acceptable level. Examples of such safeguards include:
 - Having a professional accountant review the work of the member of the assurance team; or
 - Excluding the individual from any significant decision-making concerning the assurance engagement.

The firm shall determine whether to discuss the matter with those charged with governance, [or a subgroup thereof](#).

291.127 When an inadvertent violation of this section as it relates to family and personal relationships occurs, it is deemed not to compromise independence if:

- (a) The firm has established policies and procedures that require prompt notification to the firm of any breaches resulting from changes in the employment status of their immediate or close family members or other personal relationships that create threats to independence;
- (b) The inadvertent violation relates to an immediate family member of a member of the assurance team becoming a director or officer of the assurance client or being in a position to exert significant influence over the subject matter information of the assurance engagement, and the relevant professional is removed from the assurance team; and
- (c) The firm applies other safeguards when necessary to reduce any remaining threat to an acceptable level. Examples of such safeguards include:
 - Having a professional accountant review the work of the member of the assurance team; or
 - Excluding the relevant professional from any significant decision-making concerning the engagement.

The firm shall determine whether to discuss the matter with those charged with governance, [or a subgroup thereof](#).

291.129 If a former member of the assurance team or partner of the firm has joined the assurance client in such a position, the existence and significance of any familiarity or intimidation threats will depend on factors such as:

- The position the individual has taken at the client;
- Any involvement the individual will have with the assurance team;
- The length of time since the individual was a member of the assurance team or partner of the firm; and
- The former position of the individual within the assurance team or firm, for example, whether the individual was responsible for maintaining regular contact with the client's management or those charged with governance, [or a subgroup thereof](#).

In all cases the individual shall not continue to participate in the firm's business or professional activities.

The significance of any threats created shall be evaluated and safeguards applied when necessary to eliminate the threats or reduce them to an acceptable level. Examples of such safeguards include:

- Making arrangements such that the individual is not entitled to any benefits or payments from the firm, unless made in accordance with fixed pre-determined arrangements.
- Making arrangements such that any amount owed to the individual is not material to the firm;

- Modifying the plan for the assurance engagement;
- Assigning individuals to the assurance team who have sufficient experience in relation to the individual who has joined the client; or
- Having a professional accountant review the work of the former member of the assurance team.

320.5 The significance of such threats will depend on factors such as the source of the pressure and the degree to which the information is, or may be, misleading. The significance of the threats shall be evaluated and safeguards applied when necessary to eliminate them or reduce them to an acceptable level. Such safeguards include consultation with superiors within the employing organization, ~~the audit committee or~~ those charged with governance of the organization, or a subgroup thereof, or with a relevant professional body.

340.2 The significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. In evaluating the significance of any threat, and, when necessary, determining the appropriate safeguards to be applied to eliminate the threat or reduce it to an acceptable level, a professional accountant in business shall evaluate the nature of the financial interest. This includes evaluating the significance of the financial interest and determining whether it is direct or indirect. What constitutes a significant or valuable stake in an organization will vary from individual to individual, depending on personal circumstances. Examples of such safeguards include:

- Policies and procedures for a committee independent of management to determine the level or form of remuneration of senior management.
- Disclosure of all relevant interests, and of any plans to trade in relevant shares to those charged with the governance of the employing organization, or a subgroup thereof, in accordance with any internal policies.
- Consultation, where appropriate, with superiors within the employing organization.
- Consultation, where appropriate, with those charged with the governance of the employing organization, or a subgroup thereof, or relevant professional bodies.

350.4 The significance of any threats shall be evaluated and safeguards applied when necessary to eliminate them or reduce them to an acceptable level. When the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, a professional accountant in business shall not accept the inducement. As the real or apparent threats to compliance with the fundamental principles do not merely arise from acceptance of an inducement but, sometimes, merely from the fact of the offer having been made, additional safeguards shall be adopted. A professional accountant in business shall evaluate any threats created by such offers and determine whether to take one or more of the following actions:

- (a) Informing higher levels of management or those charged with governance of the employing organization, or a subgroup thereof, immediately when such offers have been made;
- (b) Informing third parties of the offer – for example, a professional body or the employer of the individual who made the offer; a professional accountant in business may however, consider seeking legal advice before taking such a step; and

- (c) Advising immediate or close family members of relevant threats and safeguards where they are potentially in positions that might result in offers of inducements, for example, as a result of their employment situation; and
- (d) Informing higher levels of management or those charged with governance of the employing organization, or a subgroup thereof, where immediate or close family members are employed by competitors or potential suppliers of that organization.

The *Code of Ethics for Professional Accountants*, Exposure Drafts, Consultation Papers, and other IESBA publications are published by, and copyright of, IFAC.

The IESBA and IFAC do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

The IESBA logo, 'International Ethics Standards Board for Accountants', 'IESBA', '*The Code of Ethics for Professional Accountants*', the IFAC logo, 'International Federation of Accountants', and 'IFAC' are trademarks and service marks of IFAC.

Copyright © July 2012 by the International Federation of Accountants (IFAC). All rights reserved. Permission is granted to make copies of this work to achieve maximum exposure and feedback provided that each copy bears the following credit line: "*Copyright © July 2012 by the International Federation of Accountants (IFAC). All rights reserved. Used with permission of IFAC. Permission is granted to make copies of this work to achieve maximum exposure and feedback.*"



**International
Ethics Standards
Board for Accountants**

529 Fifth Avenue, 6th Floor, New York, NY 10017
T + 1 (212) 286-9344 F +1 (212) 286-9570
www.ethicsboard.org

IESBA PROPOSES CHANGE TO CODE OF ETHICS DEFINITION OF THOSE CHARGED WITH GOVERNANCE

(New York, July 20, 2012) – The International Ethics Standards Board for Accountants (IESBA) today released for public exposure a [proposed change to the definition](#) of “those charged with governance” in the IESBA *Code of Ethics for Professional Accountants* (the Code).

The objectives of the change are to more closely align the definition of “those charged with governance” in the Code with that in the IAASB’s International Standard on Auditing (ISA) 260, *Communication with Those Charged with Governance*, and to eliminate any confusion as to how it is defined. The IESBA is of the opinion that the proposals do not call for any change in systems or common practice, should they be approved.

The change specifically aims to clarify that a subgroup, such as an audit committee, may assist the governing body in meeting its responsibilities. In those cases, the auditor shall determine with whom within the entity’s governance structure to communicate.

“Through this Exposure Draft, the IESBA seeks to ascertain whether the proposed change to the definition adequately clarifies the term ‘those charged with governance.’ The IESBA believes this will contribute to more consistent application of the Code, which is critical to our mission to support the global adoption and implementation of the Code,” said Ken Dakdduk, chair of the IESBA.

How to Comment

The IESBA invites all stakeholders to comment on its proposals in the Exposure Draft, [Proposed Change to the Definition of “Those Charged with Governance.”](#) To submit a comment, visit the IESBA website at www.ethicsboard.org. Comments on the Exposure Draft are requested by **October 31, 2012.**

About the IESBA

The [International Ethics Standards Board for Accountants](#) (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. Please visit www.ethicsboard.org for more information.

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. IFAC is comprised of 167 members and associates in 127 countries and jurisdictions, representing approximately 2.5 million accountants in public practice, education, government service, industry, and commerce.