



American Institute of CPAs  
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## VIA E-MAIL

January 23, 2012

International Ethics Standards Board for Accountants  
International Federation of Accountants  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, NY 10017

Re: Exposure Draft: *Proposed Changes to the Code of Ethics for Professional Accountants Related to Provisions Addressing a Breach of a Requirement of the Code*

Dear Members of the International Ethics Standards Board for Accountants:

The American Institute of Certified Public Accountants' (AICPA) Professional Ethics Executive Committee (PEEC) is pleased to submit this comment letter to the International Ethics Standards Board for Accountants (IESBA) on its Exposure Draft: *Proposed Changes to the Code of Ethics for Professional Accountants Related to Provisions Addressing a Breach of a Requirement of the Code* (the "Exposure Draft").

We support the IESBA's efforts to review and strengthen, where necessary, the requirements contained in the IESBA *Code of Ethics for Professional Accountants* (the "Code"). Throughout its history the AICPA has been deeply committed to promoting and strengthening independence and ethics standards. Through the PEEC, the AICPA devotes significant resources to independence and ethics activities, including evaluating existing standards, proposing new standards, and interpreting and enforcing those standards.

### General Comments

We agree with the IESBA that it is in the public interest to have a robust framework that provides guidance to professional accountants when encountering breaches of the Code. While a regulatory process exists in the United States for appropriate consultation with regulators and professional associations when a breach is identified, we recognize that many jurisdictions do not have a formal process for dealing with such breaches and therefore, guidance on appropriate steps to be taken would benefit professional accountants and users of the Code.

## **Responses to Request for Specific Comments**

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

Yes. As noted above, due to the fact that many jurisdictions do not have a formal process for dealing with breaches of the Code, we believe it is appropriate for the Code to provide guidance on this subject.

### **2. Do respondents agree with the overall approach proposed to deal with a breach of an independence requirement, including the proposal that the firm may continue with the audit engagement only if those charged with governance agree that action can be taken to satisfactorily address the consequences of the breach and such action is taken?**

We agree with the approach proposed to deal with a breach of an independence requirement, other than as noted in comments on the requirement to report all breaches and the use of the reasonable and informed third party test discussed in nos. 3 and 4 below.

### **3. Do respondents agree that a firm should be required to communicate all breaches of an independence requirement to those charged with governance? If not, why not and what should be the threshold for reporting?**

There may be circumstances where it is appropriate for a firm to not be required to communicate certain breaches to those charged with governance. Those charged with governance at the client and the firm could exercise professional judgment to establish a protocol for the reporting of certain breaches. Those charged with governance may determine that they do not wish to be notified of trivial and inconsequential breaches that have little or no bearing on the firm's objectivity. An example might be where a spouse of a partner in the office of the engagement partner purchases an immaterial amount of shares of a client and disposes of them the next day, which would be a breach of an independence requirement but may not impact the firm's objectivity.

Accordingly, we suggest that the IESBA consider revising this requirement such that those charged with governance, in consultation with the firm, have the ability to establish an appropriate policy that sets a threshold for the reporting of certain breaches. The firm can always communicate breaches that fall below an established threshold if in their professional judgment it is in the interest of those charged with governance.

The concept recommended in the above paragraph respects two core concepts of the Exposure Draft: 1) that a firm must determine whether termination of an audit engagement is necessary, and 2) whether action can be taken to satisfactorily address the consequences of a breach such that the firm can still issue an audit opinion. The firm would always be required to evaluate the significance of any breach and its impact on the firm's objectivity.

**4. Do respondents agree that the reasonable and informed third party test should be used in determining whether an action satisfactorily addresses the consequences of a breach of an independence requirement? If not, why not and what should the test be?**

A “reasonable and informed third party test” is used in several parts of the Code when an accountant is to consider an action or circumstance. In proposed paragraph 290.43, the accountant is to take the view of a hypothetical third party to weigh the significance of a breach in making a conclusion as to whether the firm’s objectivity would be compromised such that the firm is unable to issue an audit report.

While we acknowledge that the reasonable and informed third party test is appropriate for considering certain independence matters addressed in the Code, such as whether threats have been eliminated or reduced to an acceptable level, it may not be appropriate to use such a test when considering whether the actions to be taken by the firm would satisfactorily address the consequences of a breach. Specifically, we believe it would be difficult for a firm to determine what a reasonable and informed third party would likely conclude to be an appropriate course of action for addressing a breach of the independence requirements, and the impact of that action on independence and objectivity. We believe it would be more appropriate to allow the use of the firm’s professional judgment with agreement by those charged with governance, to determine whether the actions taken satisfactorily address the consequences of the breach such that the firm’s objectivity would not be compromised.

If the reasonable and informed third party test is to be adopted as exposed, we recommend that in addition to the significance of the breach, the third party should weigh the action to be taken by the firm. Adding that to the language in proposed paragraph 290.43 would be: “...a reasonable and informed third party, weighing the significance of the breach and the action to be taken...”. That would make this test comparable to other uses of a third party test in the Code. Alternatively, adoption of identical language used elsewhere in the Code would get that effect. The following language is used in several places in the Code and could be used here: “...weighing all the specific facts and circumstances available to the professional accountant at that time...” (used in Code paragraphs 100.2(c), 100.7, 150.1, 200.10, definition of acceptable level).

**5. Do respondents agree that the matters that should be discussed with those charged with governance as proposed in section 290.46 are appropriate? If not, why not? Are there other matters that should be included, or matters that should be excluded?**

Yes. We believe that the matters to be discussed with those charged with governance as set forth in proposed paragraph 290.46 are appropriate.

**6. Do respondents agree with the impact analysis as presented? Are there any other stakeholders, or other impacts on stakeholders, that should be considered and addressed by the IESBA?**

With the exception of the issue noted under “Documentation” below in our “Other Comments” section, we agree with the impact analysis as presented. We are not aware of additional stakeholders that should be considered.

**7. Would the proposal require firms to make significant changes to their systems or processes to enable them to properly implement the requirements? If so, does the proposed effective date provide sufficient time to make such changes?**

Yes. We believe that the proposal would result in firms having to make significant changes to their quality control and independence systems. For example, while many large firms have developed independence tracking systems and closely monitor investments and other relationships with listed entities, we do not believe the same level of monitoring may exist for non-listed entities. Accordingly, we believe firms will need to invest resources in enhancing their existing systems or developing new systems or processes to implement the proposed requirements. Due to the time necessary to implement the new systems and processes as well as educate firm personnel on the new requirements, we recommend at least an additional year and have the new requirements become effective for breaches identified on and after January 1, 2014.

**8. Is the abbreviated version of the framework described in Section 290 for dealing with a breach of an independence requirement suitable for Section 291? If not, what do respondents believe Section 291 should contain?**

Yes. We believe the abbreviated guidance proposed is suitable for Section 291.

**Other Comments**

*Evaluating significance of breach*

Paragraph 290.42 provides guidance to assist the firm when evaluating the significance of a breach and its impact on the firm’s objectivity and ability to issue an audit report. While we agree that the guidance should address all types of independence breaches, not just those that are considered to be inadvertent, we recommend that whether the breach was inadvertent or done with knowledge should be a consideration when evaluating the significance of the breach. Accordingly, we recommend the following be added to the bulleted list:

*“Whether the breach was inadvertent or if the firm or individual had knowledge that the interest or relationship resulted in a breach.”*

*Documentation*

Paragraph 290.50 states that “The firm shall document the action taken and all the matters discussed with those charged with governance and, if applicable, discussions with relevant regulators.” We believe the term “if applicable” is unclear as used in this sentence. We recommend the sentence be replaced with the following:

*“The firm shall document the action taken and all the matters discussed with those charged with governance and any discussions with relevant regulators.”*

In addition, we noted that in the discussion of this new requirement in the impact analysis, it indicates that the impact to “Auditors/accountants” is “Significant because a documentation requirement puts an added rigor into the process of dealing with a breach *and will inform audit regulators*, who could challenge the firm and audit committee’s judgments” (emphasis added). If the impact analysis is published, we would recommend that this statement be clarified to reflect that the Code does not contain a requirement to inform audit regulators.

We appreciate this opportunity to comment. We would be pleased to discuss in further detail our comments and any other matters with respect to the IESBA’s Exposure Draft.

Sincerely,

A handwritten signature in cursive script that reads "Wes Williams, CPA".

Wes Williams, CPA  
Chair, Professional Ethics Executive Committee, AICPA

cc: Kenneth Dakdduk, Chair, IESBA  
Lisa A. Snyder, Director, Professional Ethics Division, AICPA