



**Meeting Location:** InterContinental Eros, Nehru Place, New Delhi

**Meeting Date:** February 6-8, 2011

## Inadvertent Violation

### Objective of Agenda Item

1. To consider the Task Force proposals and to provide input on the proposed draft wording.

### Background

The Code contains several paragraphs that address an inadvertent violation of a provision of the Code. The Code's inadvertent violations provisions were commented on by the International Organization of Securities Commissions ("IOSCO") in its response to the IESBA's Drafting Conventions Exposure Draft, issued in July 2008. Appendix A contains the text of their comments. The IESBA recognized the concern expressed by IOSCO but concluded that the issues raised were beyond the scope of that ED and would, therefore, need to be considered separately.

In 2010, the IESBA assessed the provisions in the Code that address an inadvertent violation and concluded that a project should be undertaken to reconsider those provisions, including determining whether the provisions are needed and, if so, how the guidance can be enhanced with regard to scope and application. At its November 2010 meeting, the IESBA approved a project proposal to address this matter (Agenda Paper 8-A).

The Task Force<sup>1</sup> met on December 6-7, 2010 and January 10-11, 2011 to consider the issues outlined in the project proposal, to develop recommendations for the IESBA to consider and to develop proposed wording for the Code.

The Task Force first considered the inadvertent violation provisions that relate to auditor independence and then considered the general inadvertent violation provision contained in paragraph 110.10. The Task Force took this approach because the discussion of an inadvertent violation tends to focus on independence and the Task Force felt that it would be useful to discuss the appropriateness of the specific application of the provisions in the

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context of independence before discussing the appropriateness of the more general application in paragraph 110.10. This agenda paper follows this approach.

## **Discussion**

### **Need for Provisions to Address an Inadvertent Violation of an Independence Requirement**

In considering the need for a provision to address an inadvertent violation of an independence requirement, the Task Force first considered the objective of such a provision. The Code states that a distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. The Task Force is of the view that the purpose of the provisions is not to protect the accountant but to ensure the public interest is protected when a professional accountant has failed to comply with a provision of the Code. In the case of the independence provisions, if the automatic consequence of any violation is that the firm is not independent and therefore unable to continue the audit engagement, regardless of the magnitude of the violation, the public interest may not be well served. The company would need to find another auditor and, depending upon the timing, might have difficulties meeting filing requirements and have to deal with all of the adverse consequences and market reaction of missing a regulatory deadline. In such circumstances the consequence of the violation, to the client and its stakeholders, may well be disproportionate to the violation.

With this backdrop, the Task Force identified the following arguments for and against retaining any provisions:

#### *Arguments for Provisions*

- Despite having policies and procedures in place to maintain independence, violations will occur from time to time;
- When an independence violation does occur it will call into question the firm's ability to continue with the audit. Firms should have to follow a consistent, rigorous, and transparent process to answer that question;
- Not all jurisdictions have a regulator or an adequate regulatory process for dealing with violations. The Code should address the matter for such jurisdictions.
- In many jurisdictions those charged with governance of the client have a responsibility to evaluate the independence of the auditors, including dealing with matters concerning independence violations. The Code can provide assistance to such audit committees; and
- Without such guidance, professional accountants and their firms would be left to deal with such situations on an ad hoc basis with no guidance to promote a consistent and transparent process.

#### *Arguments against Provisions*

- The provisions could be viewed as providing an exception to a requirement under the Code, or allowing an easy avenue for a professional accountant to "cleanse" a violation. This may increase the risk of abuse or discourage professional

- accountants from focusing on compliance with the Code. This would not be in the public interest.
- The Code should focus on what is required and the consequences of an inadvertent violation should be left to those who have responsibility for enforcing the Code.
  - Regulation should not include guidance on how to address violations of the provisions – for example law may not necessarily include provisions on how a violation of a law will be addressed.

The Task Force considered the arguments for and against and concluded that the Code should contain such a provision because the public interest will be better served by such provisions. The provisions can require action to be taken to mitigate the adverse consequences of the violation if possible and address what might, depending upon the situation, otherwise be a disproportionate outcome to the audit client (auditor resignation). The Task Force notes that such provisions can be found in the requirements of some other jurisdictions (Appendix C).

The Task Force does not consider that the Code should be silent on the matter. In some jurisdictions, there may be no regulator or regulatory process for dealing with such matters. Violations will occur from time to time and silence on this matter can lead to jurisdictions and professional accountants adopting inconsistent practices and interpretations to address violations. The Code should provide guidance on a minimum acceptable appropriate and transparent process to address this matter and the consequences on the ability of the auditor to render an independent audit opinion. This will promote consistency of approach, which is in the public interest.

The Task Force recognizes that significant concern has been raised with the current independence provisions related to an inadvertent violation and the Task Force is of the view that it may be the drafting of the current provisions that is the cause of this concern as opposed to the need for an appropriate mechanism to address violations.

#### **Action requested**

IESBA members are asked to consider whether they agree with the Task Force's view that the Code should contain provisions addressing an inadvertent violation of an independence provision of the Code.

#### **Review of Existing Language**

Paragraph 290.309 states that an inadvertent violation is generally not deemed to compromise independence provided certain conditions are met. No guidance is provided on the meaning of inadvertent. When commenting on this matter IOSCO noted:

“The Code has provided an exception for “inadvertent” violations of the requirements, stating that such violations are not deemed, or shall not be deemed,

to compromise independence provided certain conditions are met and adequate safeguards are applied. We believe that writing an exception for inadvertent violations which implies that all such violations can be corrected through application of “any necessary safeguards”, may encourage unscrupulous behavior and potential abuse of compliance with the Code and should be removed....If an exception for inadvertent violations is retained in the Code we urge the Board to include a sufficiently narrow and prescriptive definition of the term “inadvertent” as well as include a materiality threshold for evaluating when an inadvertent violation could and could not be deemed to compromise independence.”

The Task Force considered this comment and also reviewed comparable similar provisions in other jurisdictions that (see Appendix C). In summary:

- The SEC rules state that an accounting firm's independence will not be impaired solely because a covered person in the firm is not independent of an audit client provided certain conditions are met, including that the covered person did not know of the circumstances giving rise to the lack of independence. The guidance addresses only a covered person's independence and makes no reference to “inadvert”.
- The APB addresses both breaches and inadvertent violations. With respect to inadvertent violations, it states that it does not necessarily call into question the firm's ability to give an audit opinion provided certain conditions are met. No guidance is provided on the meaning of inadvertent.

#### *Inadvertent*

The Task Force considered whether the term “inadvertent” was the appropriate descriptor and, if so, whether any additional guidance should be given on its meaning. The Task Force focused on the objective of the provisions which is to provide a robust and transparent mechanism to address an inadvertent violation of a provision of the Code such that the automatic consequence is not that independence is compromised such that resignation is necessary. Such an automatic consequence may be disproportionate to the magnitude of the violation and thus would not always be in the public interest. For example, the client may find it difficult to respect filing requirements if required to terminate the audit firm and engage another.

The Task Force concluded that the designation of “inadvertent” was not helpful. If a violation has occurred, an analysis needs to be undertaken to determine whether actions can be taken such that the firm can provide the audit opinion or whether resignation is necessary. Whether the action creating the violation was inadvertent or not does not alter the fact that the firm needs to evaluate the implications of the violation and take action. Resignation from the audit can be a disproportionate outcome irrespective of whether the violation was inadvertent or not. The disproportionate outcome can be of the same magnitude whether the violation was inadvertent or not.

The Task Force is of the view that the provisions should establish a transparent and robust process to address a violation of a provision of the Code, irrespective of how the violation occurred.

*Deemed not to Compromise Independence*

The Task Force reviewed this language and noted that concern had been expressed with the term. The Task Force noted other jurisdictions (for example the SEC and APB) do not make what could be seen as a blanket statement that violations are “deemed not to compromise independence” (provided certain conditions are met). The Task Force is of the view that if an independence provision is violated, independence is by definition compromised and it is not, therefore, helpful to have language saying that it is deemed not to compromise independence. The Task Force is also of the view that the significance of a violation may be such that the audit cannot continue and resignation is necessary.

**Action Requested**

IESBA members are asked to consider whether they agree that the provisions should focus on establishing a robust and transparent mechanism to address the consequences of a violation, irrespective of how that violation occurred.

IESBA members are also asked whether they agree that a violation does compromise independence and it is, therefore, unhelpful to state that it may be deemed not to compromise independence.

**Types of Possible Violation**

The discussion of violations often focuses on financial interests and the SEC provisions for example relate only to the personal independence of the “covered person”. The Task Force, therefore, considered other categories of possible violations to determine whether the provisions should apply to all independence provisions or be limited to, for example only the financial interest provisions.

The Task Force identified the following examples of violations, among others, that are not related to financial interests:

- Partner Rotation – An individual who had previously been the engagement partner on a public interest entity audit client might be approached to be engagement quality control reviewer for that entity. The individual may agree and the appointment is announced to the client and staff. One month later, the individual, who has started some preliminary work associated with the audit, realizes that he has not completed the necessary two year cooling off period since being an engagement partner. (290.151)
- A network firm, which is not involved in the audit, realizes that it has provided a prohibited non-assurance service to a subsidiary of a public interest entity audit client – for example a valuation that is material to the audit client (290.180)

- A network firm, which is not involved in the audit, discovers it has provided a prohibited non-assurance service to an immaterial subsidiary of a public interest entity audit client – for example, has authorised a transaction on behalf of the audit client (290.163)
- A network firm, which is not involved in the audit, discovers it has a close business relationship with a non-executive director of an immaterial subsidiary of a public interest entity audit client. The business relationship is material to the director of the subsidiary (290.124)

The Task Force concluded that what was relevant was the consequence of the violation as opposed to the interest or relationship that caused the violation. For example if the consequence of the violation is that the audit client is required to find a replacement auditor to complete the year's audit, it would not matter whether the violation was created by the holding of a prohibited financial interest or the provision of a non-assurance service. The impact of the violation and, therefore, the actions to be taken to address the violation may differ, but both types of violation need to be addressed.

#### **Action Requested**

IESBA members are asked to consider whether they agree that the provisions should address a violation of any independence provision and should not be limited to financial interests.

#### **Actions to be Taken**

Paragraph 290.39 states that if an inadvertent violation occurs, it generally will be deemed not to compromise independence if:

- The firm has appropriate quality control policies and procedures equivalent to ISQC1;
- Once discovered the violation is corrected promptly; and
- Any necessary safeguards are applied to eliminate the threat or reduce it to an acceptable level.

The firm is also required to determine whether to discuss an inadvertent violation of a provision related to independence with those charged with governance.

Some of the specific provisions addressing independence provide examples of safeguards:

- Having a professional accountant review the work of the member of the audit team; or
- Excluding the relevant professional from any significant decision-making concerning the engagement

ISA 260.17 *Communication with Those Charged with Governance* requires the following:

“In the case of listed entities, the auditor shall communicate with those charged with governance...all relationships and other matters between the firm, network firms, and the entity, that, in the auditor’s professional judgment, might reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity...”

Paragraph 260.A22 states:

“The communication required by paragraph 17(a) may include an inadvertent violation of relevant ethical requirements as they related to independence, and any remedial action taken or proposed.”

The consideration of the impact of the violation could be seen as implicitly included in the requirement to apply any necessary safeguards to eliminate the threat or reduce it to an acceptable level. For example, if the threat created by the violation was so significant that no safeguard could reduce it to an acceptable level, the firm would need to resign. The Task Force felt that while it might be implicit from the requirement, there should be an explicit requirement for the firm to evaluate the impact of the violation to determine whether the matter could be mitigated or whether resignation was necessary.

The Task Force considered the process that should be followed if a violation is identified. The Task Force felt that the process should include:

- An evaluation of the significance of the violation;
- A determination of whether corrective measures were available to resolve the situation or whether resignation was necessary;
- Resignation or application of the corrective measures;
- Discussion with those charged with governance; and
- Documentation.

The Code currently requires the firm to determine whether to discuss the matter with those charged with governance and ISA 260 indicates such matters might be communicated. The Task Force is of the view that a violation of an independence requirement is generally a matter that should be communicated to those charged with governance because such matters are important for those charged with governance to discharge their responsibilities. The Task Force recognizes that some violations may, however, be of a very trivial nature such as, for example, a financial interest violation created if the dependent son of a partner in the office of engagement partner purchases some shares in an audit client of that office. The Task Force noted that such a violation does not have to be reported to those charged with governance under, for example, SEC, APB or Australian requirements. The Task Force, therefore, believes that the Code should not require reporting of these types of violations. The Task Force also recognized that those charged with governance may decide that it does not want matters that are

trivial and inconsequential to be discussed. The Task Force therefore proposes that the auditor should obtain an understanding of any such policy from those charged with governance. The Task Force is of the view, however, that even if such a policy exists, the auditor should still determine whether, irrespective of such a policy, a particular violation should still be discussed with those charged with governance.

The Task Force proposes that the discussion with those charged with governance addresses the following factors:

- The nature and significance of the violation;
- Any corrective measures taken or proposed;
- The rationale as to whether, in the firm's professional judgment, the corrective measures resolve the situation such that the firm can continue the audit engagement;
- A description of the firm's policies and procedures designed to provide it with reasonable assurance that independence is maintained; and
- An explanation of why, despite the policies and procedures, the violation occurred, and the steps taken or proposed to address any identified weakness in those policies and procedures.

The documentation requirements should reflect the nature of the discussion with those charged with governance.

**Action requested**

IESBA members are asked to consider the proposed required actions.

IESBA members are asked to consider whether the provisions should state that those charged with governance may determine that certain violations need not be communicated.

IESBA members are also asked to consider whether they agree that violations described in proposed 290.47 need not be discussed with those charged with governance.

**Need for Provisions to Address Other Parts of the Code**

The majority of the requirements ("shalls") in the Code relate to the requirement to evaluate the significance of a threat to compliance with a fundamental principle and apply safeguards to eliminate any threat or reduce it to an acceptable level. The Task Force identified the following other requirements to consider whether they should be included in the scope of any inadvertent violation provisions:

- A professional accountant shall maintain confidentiality, including in a social environment, being alert to the possibility of inadvertent disclosure, particularly to a close business associate or a close or immediate family member (140.2)



- A professional accountant shall maintain confidentiality of information disclosed by a prospective client or employer (140.3)
- In marketing and promoting themselves and their work, professional accountants shall not bring the profession into disrepute. Professional accountants shall be honest and truthful and not... make exaggerated claims for the services they are able to offer, the qualifications they possess, or experience they have gained; or...make disparaging references or unsubstantiated comparisons to the work of others (150.2)
- A professional accountant in public practice shall not knowingly engage in any business, occupation, or activity that impairs or might impair integrity, objectivity or the good reputation of the profession and as a result would be incompatible with the fundamental principles (200.2)
- A professional accountant in public practice who is asked to replace another professional accountant in public practice, or who is considering tendering for an engagement currently held by another professional accountant in public practice, shall determine whether there are any reasons, professional or otherwise, for not accepting the engagement, such as circumstances that create threats to compliance with the fundamental principles that cannot be eliminated or reduced to an acceptable level by the application of safeguards. (210.9)
- 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. (201.14)
- Where a conflict of interest creates a threat to one or more of the fundamental principles, including objectivity, confidentiality, or professional behavior, that cannot be eliminated or reduced to an acceptable level through the application of safeguards, the professional accountant in public practice shall not accept a specific engagement or shall resign from one or more conflicting engagements. (220.5)
- A professional accountant in public practice shall not assume custody of client monies or other assets unless permitted to do so by law and, if so, in compliance with any additional legal duties imposed on a professional accountant in public practice holding such assets (270.1)

In reviewing these provisions the Task Force felt that the consequences of a violation differed from the consequences of a violation of an independence provision. A distinguishing feature of the independence provisions is the consequences the violation – if independence is violated and the firm cannot issue the opinion, the company would need to find another auditor and, depending upon the timing, might have difficulties meeting filing requirements. If the violation was trivial or inconsequential the

consequences would, therefore, be disproportionate to the violation. In the case of the other provisions in the Code, there are not the same consequences to the public. Given that the objective of the provisions should be the protection of the public and rather than the accountant, the Task Force is of the view the provisions should address only independence and, therefore, paragraph 110.10 be deleted.

**Action requested**

IESBA members are asked to consider whether they agree that the provisions should apply only to independence.

**Material Presented**

Agenda Paper 8	This Agenda Paper
Agenda Paper 8-A	Approved Project Proposal
Agenda Paper 8-B	Proposed draft paragraphs

**Action Requested**

1. IESBA members are asked to consider the questions raised in the paper

## **Appendix A**

In its response to the Drafting Conventions Exposure Draft, IOSCO made the following comments on the inadvertent violations provisions in the Code:

“The Code has provided an exception for “inadvertent” violations of the requirements, stating that such violations are not deemed, or shall not be deemed, to compromise independence provided certain conditions are met and adequate safeguards are applied. We believe that writing an exception for inadvertent violations which implies that all such violations can be corrected through application of “any necessary safeguards”, may encourage unscrupulous behavior and potential abuse of compliance with the Code and should be removed.

Paragraph 290.117 (a) states, in part “ [T]he firm has established policies and procedures that require prompt notification to the firm of any breaches from the purchase...of a financial interest in an audit client.” Given that a “purchase” of a financial interest is a conscious action, it does not seem appropriate to characterize this action as “inadvertent”, especially given a firm should have adequate policies and procedures in place to avoid this type of situation. The example highlights the potential for abuse in deeming any violation as “inadvertent” and simply applying remediation procedures subsequent to the violation.

A broad exception for inadvertent violations could detract from motivating Firms to establish robust preventative controls to properly identify threats to independence prior to providing prohibited services. If an exception for inadvertent violations is retained in the Code we urge the Board to include a sufficiently narrow and prescriptive definition of the term “inadvertent” as well as include a materiality threshold for evaluating when an inadvertent violation could and could not be deemed to compromise independence.”

## **Appendix B**

### **Inadvertent Violation Provisions in the Code**

The paragraphs addressing an inadvertent violation in the current Code are:

#### **Introduction**

100.10 A professional accountant may inadvertently violate a provision of this Code. Depending on the nature and significance of the matter, such an inadvertent violation may be deemed not to compromise compliance with the fundamental principles provided, once the violation is discovered, the violation is corrected promptly and any necessary safeguards are applied.

#### **Independence – Audit and Review Engagements**

##### *Introduction*

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 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.

##### *Financial Interests*

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.

##### *Family and personal relationships*

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.

*Provision of non-assurance services to audit clients*

- 290.159 Providing certain non-assurance services to an audit client may create a threat to independence so significant that no safeguards could reduce the threat to an acceptable level. However, the inadvertent provision of such a service to a related entity, division or in respect of a discrete financial statement item of such a client will be deemed not to compromise independence if any threats have been reduced to an acceptable level by arrangements for that related entity, division or discrete financial statement item to be audited by another firm or when another firm re-performs the non-assurance service to the extent necessary to enable it to take responsibility for that service.

**Independence – Other Assurance Engagements**

*Introduction*

- 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.

*Financial interests*

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:
  - (i) Having a professional accountant review the work of the member of the assurance team; or
  - (ii) 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.

*Family and personal relationships*

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.

## **Appendix C**

### **Examples of Inadvertent Violation Provisions in other Jurisdictions**

#### *US Securities and Exchange Commission*

Section 210.2-01(d) *Quality Controls* provides that an accounting firm's independence will not be impaired solely because a covered person in the firm is not independent of an audit client provided:

- (1) The covered person did not know of the circumstances giving rise to the lack of independence;
- (2) The covered person's lack of independence was corrected as promptly as possible under the relevant circumstances after the covered person or accounting firm became aware of it: and
- (3) The accounting firm has a quality control system in place that provides reasonable assurance, taking into account the size and nature of the accounting firm's practice, that the accounting firm and its employees do not lack independence, and that covers at least all employees and associated entities of the accounting firm participating in the engagement, including employees and associated entities located outside of the United States.
- (4) For an accounting firm that annually provides audit, review, or attest services to more than 500 companies with a class of securities registered with the Commission under section 12 of the Securities Exchange Act of 1934 (15 U.S.C 78l), a quality control system will not provide such reasonable assurance unless it has at least the following features:
  - (i) Written independence policies and procedures;
  - (ii) With respect to partners and managerial employees, an automated system to identify their investments in securities that might impair the accountant's independence;
  - (iii) With respect to all professionals, a system that provides timely information about entities from which the accountant is required to maintain independence;
  - (iv) An annual or on-going firm-wide training program about auditor independence;
  - (v) An annual internal inspection and testing program to monitor adherence to independence requirements;
  - (vi) Notification to all accounting firm members, officers, directors, and employees of the name and title of the member of senior management responsible for compliance with auditor independence requirements;
  - (vii) Written policies and procedures requiring all partners and covered persons to report promptly to the accounting firm when they are engaged in employment negotiations with an audit client, and requiring the firm to remove immediately any such professional from that audit client's



engagement and to review promptly all work the professional performed related to that audit client's engagement; and

- (viii) A disciplinary mechanism to ensure compliance with this section.

*U.S. Government Accountability Office*

**3.09** When the audit organization identifies a personal impairment to independence prior to or during an audit, the audit organization should take action to resolve the impairment in a timely manner. In situations in which the personal impairment is applicable only to an individual auditor or a specialist on a particular audit, the audit organization may be able to eliminate the personal impairment. For example, the audit organization could remove that auditor or specialist from any work on that audit or require the auditor or specialist to eliminate the cause of the personal impairment. If the personal impairment cannot be eliminated, the audit organization should withdraw from the audit. In situations in which auditors employed by government entities cannot withdraw from the audit, they should follow paragraph 3.04.

**3.04** When evaluating whether independence impairments exist either in fact or appearance with respect to the entities for which audit organizations perform audits or attestation engagements, auditors and audit organizations must take into account the three general classes of impairments to independence--personal, external, and organizational. If one or more of these impairments affects or can be perceived to affect independence, the audit organization (or auditor) should decline to perform the work--except in those situations in which an audit organization in a government entity, because of a legislative requirement or for other reasons, cannot decline to perform the work, in which case the government audit organization must disclose the impairment(s) and modify the GAGAS compliance statement. (See paragraphs 1.12 and 1.13.)

*UK APB Ethical Standard 1*

28. Whenever a possible or actual breach of an APB Ethical Standard, or of policies and procedures established pursuant to the requirements of an APB Ethical Standard is identified, the audit engagement partner, in the first instance, and the ethics partner, where appropriate, assesses the implications of the breach, determines whether there are safeguards that can be put in place or other actions that can be taken to address any potential adverse consequences and considers whether there is a need to resign from the audit engagement.

29 An inadvertent violation of this Standard does not necessarily call into question the audit firm's ability to give an audit opinion, provided that:

- (a) The audit firm has established policies and procedures that require all partners and staff to report any breach promptly to the audit engagement partner or to the ethics partner, as appropriate;

- (b) The audit engagement partner or ethics partner promptly notifies the relevant partner or member of staff that any matter which has give rise to a breach is to be addressed as soon as possible and ensures that such action is taken;
- (c) Safeguards, where appropriate, are applied (for example, having another partner review the work done by the relevant partner or member of staff or removing him or her from the engagement team); and
- (d) The actions taken and the rationale for them are documented.

Australia APESB

100.10 A Member may inadvertently violate a provision of this Code. Depending on the nature and significance of the matter, such an inadvertent violation may be deemed not to compromise compliance with the fundamental principles provided, once the violation is discovered, the violation is corrected promptly and any necessary safeguards are applied.

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 APES 320 *Quality Control for Firms*, 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.

AUST290.39.1 Unless an inadvertent violation of this section is trivial and inconsequential, a Firm shall document and discuss it with Those Charged with Governance.

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 Member 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. 57

AUST290.117.1 Unless an inadvertent violation of this section as it relates to a Financial Interest in an Audit Client is trivial and inconsequential, the Firm shall document and discuss it with Those Charged with Governance.

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 Member 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.

AUST290.133.1 Unless an inadvertent violation of this section as it relates to family and personal relationships is trivial and inconsequential, the Firm shall document and discuss it with Those Charged with Governance.

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290.159 Providing certain non-assurance services to an Audit Client may create a threat to Independence so significant that no safeguards could reduce the threat to an Acceptable Level. However, the inadvertent provision of such a service to a Related Entity, division or in respect of a discrete Financial Statement item of such a client will be deemed not to compromise Independence if any threats have been reduced to an Acceptable Level by arrangements for that Related Entity, division or discrete Financial Statement item to be audited by another Firm or when another Firm re-performs the non-assurance service to the extent necessary to enable it to take responsibility for that service.