

Meeting: IESBA CAG

Meeting Location: Paris, France

Meeting Date: March 7, 2016

Agenda Item

B

Safeguards Phase II—Report-Back, Issues and Task Force Recommendations

Objectives of Agenda Item

1. To note the report-back on the September 2015 CAG discussion.
2. To obtain CAG Representatives' views on:
 - (a) Proposed revisions pertaining to safeguards in certain paragraphs within the International Independence Standards C-1, Independence—Audit and Review Engagements, Section 400 of the proposed restructured Code in the IESBA's Structure Exposure Draft (see paragraph 4 of this paper).
 - (b) Issues and Task Force recommendations for a review of safeguards pertaining to non-assurance services (NAS) in the extant Code.

Project Status and Timeline

3. The IESBA approved its Safeguards Exposure Draft, [*Proposed Revisions Pertaining to Safeguards in the Code—Phase 1*](#) (ED-1) in December 2015. It included proposed revisions to the conceptual framework (CF) that are applicable to all professional accountants (i.e., Safeguards ED-1 included proposed revisions to Sections 100 and 200 of the extant Code). The deadline for comments on Safeguards ED-1 is March 21, 2016.
4. Also released in December 2015 was the ED titled, [*Improving the Structure of the Code of Ethics for Professional Accountants—Phase 1*](#) (Structure ED-1). Safeguards ED-1 used the proposed new structure and drafting conventions in Structure ED-1. The deadline for comments on Structure ED-1 is April 18, 2016. The full text of Safeguards ED-1 is included in Structure ED-1 and is shaded in gray text. For purposes of this document, Safeguards ED-1 and Structure ED-1 will be referred to as "the December 2015 EDs."
5. Phase II of the Safeguards project will include a consideration of revisions to the provisions in Section 290¹ of the Code that address the provision of NAS to audit clients. Paragraph 9 of this paper describes the scope of Phase II for the Safeguards project.
6. This project is being closely coordinated with the Structure of the Code project. Phase II proposed revisions will be drafted in the format and language of the proposed restructured Code.
7. Appendix 2 to this paper provides a project history, including links to the relevant CAG documentation.

¹ Section 290, *Independence – Audit and Review Engagements*

Report Back on September 2015 CAG Discussion

8. Below are extracts from the minutes of the September 2015 CAG meeting,² and an indication of how the project Task Force or IESBA has responded to CAG Representatives' comments.

Matters Raised	Task Force/IESBA Response
DESCRIPTION OF SAFEGUARDS	
<p>Mr. Hansen suggested that the Task Force further explain the words “not likely” used in the last sentence of the proposed description of safeguards.</p> <p>Mr. Ahmed wondered about the scope of the term “specific actions or measures” in the context of describing safeguards, and in particular whether they were actions directed at the audited entity.</p>	<p>Point accepted.</p> <p>During the meeting, Mr. Hannaford noted that there are views on both sides in terms of whether safeguards should be intended to be effective vs be actually effective. He explained the Task Force’s view that a safeguard should be an action that is effective. If the action were not effective, it would not be a safeguard.</p> <p>He also explained that Task Force intends safeguards to be engagement-specific. He noted that the extant Code refers to a number of conditions that are firm-wide or established by regulation, etc. He explained that these are not safeguards because they do not necessarily reduce threats to an acceptable level, but rather conditions to be taken into account.</p> <p>The words “not likely” have been dropped in the proposed description of safeguards in the Safeguards ED-1 as follows”</p> <p>“Safeguards are actions, individually or in combination, that the professional accountant takes that effectively eliminate threats to compliance with the fundamental principles or reduce them to an acceptable level.”</p> <p><i>[See paragraph 120.7 A2 of the Safeguards ED-1]</i></p>
<p>Mr. Hansen also suggested that paragraph 100.16³ explicitly state that conditions established by the profession, legislation, regulation, the firm or the employing organization are not safeguards.</p>	<p>Point taken into account.</p> <p>Mr. Hannaford indicated that the point would be further considered by the Task Force.</p> <p>The Safeguards ED-1 includes new application that better explains that conditions established by the profession, legislation, regulation, the firm or the employing organization can affect the likelihood of</p>

² The September 2015 CAG minutes will be approved at March 2016 IESBA CAG meeting.

³ Paragraph numbers for the Safeguards session refer to Agenda Item E.1 of the September 2015 CAG meeting agenda materials.

Matters Raised	Task Force/IESBA Response
	<p>the accountant’s identification of threats to compliance with the fundamental principles.</p> <p><i>[See paragraph 120.5 A4 of the Safeguards ED]</i></p>
<p>Mr. James suggested that the Task Force consider explicitly stating in the Code, in close proximity to paragraphs 100.6 and 100.7, that there are situations or matters that exist for which the application of safeguards is not possible, for example, an engagement partner owning shares in the audited entity. Ms. Lang agreed, and suggested that the Task Force consider merging paragraphs 100.7 and 100.8.</p> <p>Noting Mr. Hannaford’s explanation, Mr. James reiterated his view that the Code would be more robust if it stated that in some circumstances there are no safeguards to address the identified threats.</p>	<p>Point accepted.</p> <p>During the meeting, Mr. Hannaford responded that paragraph 100.18 was intended to address these concerns though not expressed as explicitly as Mr. James suggested. In response to Ms. Lang’s suggestion, he explained that paragraph 100.7 was intended to simply describe the CF, while paragraph 100.8 was intended to prominently set out the requirement.</p> <p>Proposed new application material has also been included in the final Safeguards ED-1 to explicitly indicate that there are some situations where the threat created would be so significant that no safeguards could reduce the threat to an acceptable level.</p> <p><i>[See paragraphs 120.7 A1 of the Safeguards ED-1]</i></p>
<p>Mr. James also suggested that the Task Force consider better explaining what is meant by “acceptable level” in the context of threats to compliance with the fundamental principles, for example, by redrafting paragraph 100.15 in an affirmative way.</p>	<p>Point accepted.</p> <p>During the meeting, Mr. Hannaford responded that the Task Force would further consider the suggestion.</p> <p>The Safeguards ED-1 better explains in an affirmative manner, what is meant by acceptable level as follows:</p> <p style="padding-left: 40px;">“An acceptable level is a level at which a reasonable and informed third party would likely conclude that the professional accountant complies with the fundamental principles”</p> <p><i>[See paragraph 120.6 A1 of the Safeguards ED-1]</i></p>
REASONABLE AND INFORMED THIRD PARTY	
<p>Mr. James suggested that the term “reasonable and informed third party” should instead be “reasonable and informed investor.” Ms. Molyneux disagreed, noting that the term “reasonable and informed third party” is rooted in law or regulation in many jurisdictions. She also suggested that the Task Force explain that the “reasonable and informed third party” should also be independent.</p>	<p>Points taken into account.</p> <p>The Board is of the view that applying the “reasonable and informed third party” concept is an important step established in the extant Code whereby the professional accountant considers whether there has been compliance with the</p>

Matters Raised	Task Force/IESBA Response
<p>Regarding Ms. Molyneux’s latter point, Ms. Elliott agreed and suggested that the word “conceptual” be replaced with “hypothetical.”</p> <p>Mr. Koktvedgaard suggested that the Task Force consider that the “reasonable and informed third party” may not in fact be reasonable, but instead “dynamic” as that party’s views and perspectives may change over time.</p> <p>Ms. Ceynowa agreed that the term “reasonable and informed third party” is a term defined by law or regulation. She suggested that the focus of the description should be on what is expected of a reasonable and informed third party rather than on describing who the person is. She also suggested that the Task Force revisit how the “reasonable and informed third party” test is used in the project on responding to non-compliance with laws and regulations (NOCLAR) and that there be consistency in the Code. Mr. James agreed. Mr. Ahmed suggested replacing the word “specific” in paragraph 100.10 with the word “relevant.”</p>	<p>fundamental principles.⁴</p> <p>The Board emphasizes in the Explanatory Memorandum to the Safeguards ED-1 that a reasonable and informed third party is a hypothetical person (rather than an actual person).</p> <p>It is the Board’s view that this hypothetical person should be competent and possess sufficient skills to objectively evaluate the appropriateness of the professional accountant’s judgments and conclusions. The ED clarifies this concept by proposing a more fulsome description of the term as follows:</p> <p>“The concept of a reasonable and informed third party is a test which involves an evaluation by a hypothetical person. Such a person possesses skills, knowledge and experience to objectively evaluate the appropriateness of the professional accountant’s judgments and conclusions. This evaluation entails weighing all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time that the evaluation is made to determine whether the accountant complies with the fundamental principles.”</p> <p>The Board believes that its proposed description supports professional accountants’ appropriate application of the CF (i.e., in identifying, evaluating and addressing threats).</p> <p><i>[See paragraphs 20–23 of the Explanatory Memorandum and 120.4 A1 of the Safeguards ED-1]</i></p>
<p>Ms. Lang wondered what the phrase “could reasonably be expected to know” meant and whether the PA is expected to do “know more.”</p>	<p>Point taken into account.</p> <p>Mr. Hannaford explained that the Task Force intentionally chose the word “could” versus “should,” as “should” would make the threshold too high vs.</p>

⁴ Paragraphs 100.7 of the extant Code state that “..., the professional accountant shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at the time, would be likely to conclude that the threats would be eliminated or reduced to an acceptable level by the application of the safeguards, such that compliance with the fundamental principles is not compromised.”

Matters Raised	Task Force/IESBA Response
	<p>what one could reasonably expect such a party to know.</p> <p>This phrase is carried forward from paragraph 100.3 of the extant Code.</p>
STEPPING BACK	
<p>Mr. James suggested that the Code emphasize that the PA should step back even when facts did not change, noting that it is important for the PA to take into account the broader picture of compliance with the fundamental principles once the process of identification, evaluation and addressing of threats is complete. Messrs. Ayoub and Hansen and Ms. Lang agreed.</p>	<p>Point accepted.</p> <p>The Board agreed that is important to include—as part of, and not distinct from, the application of the CF—a new requirement for the professional accountant to perform an <i>overall</i> assessment by reviewing the judgments made and overall conclusions reached. Under the Board’s proposal, the professional accountant is required to determine, through an objective lens, that threats to compliance with the fundamental principles are eliminated or reduced to an acceptable level, and that no further action is needed.</p> <p><i>[See paragraphs R120.9 and R120.4 A1 of the Safeguards ED-1]</i></p>
<p>Mr, Ayoub noted that in his view the CF should be a four rather than a three-step process that includes identifying, evaluating, addressing and re-evaluating of threats. He also wondered what would happen next after a matter has been addressed.</p>	<p>Point accepted.</p> <p>Mr. Hannaford explained that the PA needs to re-evaluate the situation as needed given that circumstances may change. He added that the Task Force was not suggesting that the process should be indefinite. Mr. Thomson, a member of the Task Force, explained that the Task Force was of the view that the steps of evaluating and re-evaluating a threat were iterative and very closely interrelated.</p> <p>The Safeguards ED-1 includes a new requirement for the professional accountant to re-evaluate and address threats when new information becomes available, or when there are changes in facts or circumstances</p> <p><i>[See paragraph R120.8 of the Safeguards ED-1].</i></p>
<p>Ms. Ceynowa wondered whether the Task Force had given consideration to situations in which a PA set out to conduct a particular service, activity or engagement and then the scope of this service, activity or engagement changes.</p>	<p>Point taken into account.</p> <p>Mr. Hannaford responded in the affirmative, as circumstances may change.</p> <p>The Task Force plans to further consider this point during Phase II of the Safeguards project.</p>
OTHER MATTERS	

Matters Raised	Task Force/IESBA Response
<p>Ms. Miller explained how the IIA addressed the concepts of objectivity and independence in the context of its standards. She suggested that the IESBA consider clarifying the interaction and linkage between the two terms as used in the Code.</p>	<p>Point accepted.</p> <p>As further discussed in paragraphs 15-21 of this paper, the Structure ED-1 included new text to clarify the linkage between objectivity and independence.</p> <p><i>[See paragraphs 3 of the Guide to the proposed restructured Code, and paragraphs 112.A1 and 400.1–400.2 of Structure ED-1.]</i></p>
<p>Mr. James was of the view that the Task Force should de-emphasize the focus of paragraphs 100.18 and 200.14 on professional accountants simply declining or discontinuing a professional activity or service, or resigning from the engagement, if the threats to compliance with the fundamental principles are not eliminated or reduced to an acceptable level. He suggested that there should instead be emphasis on the actions that the PA would still need to take to comply with the Code in such circumstances.</p>	<p>Point accepted.</p> <p>The Safeguards ED includes more robust requirements for addressing threats to compliance with the fundamental principles. The new requirement states that if the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the accountant shall address the threats by eliminating or reducing them to an acceptable level by:</p> <ul style="list-style-type: none"> (a) Eliminating the circumstances, including interests or relationships, that are creating the threats; (b) Applying safeguards, where available and capable of being applied; or (c) Declining or discontinuing the specific professional activity or service involved. <p><i>[See paragraph R120.7 of the Safeguards ED-1]</i></p>
<p>Mr. Kottvedgaard wondered about the next steps for the project.</p>	<p>Mr. Hannaford explained that the IESBA planned to approve an exposure draft of proposed revisions to Sections 100 and 200 of the extant Code in December 2015.</p>

Matters for CAG Consideration

A. Introduction

Scope of Phase II of the Safeguards Project

9. Phase II of the Safeguards project will be informed by the feedback from the respondents on the December 2015 EDs.⁵ This phase will include:
 - (a) A review of the clarity, appropriateness and effectiveness of safeguards that pertain to NAS;

⁵ The Safeguards Task Force anticipates that some of the feedback on Structure ED-1 might also be relevant to revisions that will need to be made to Safeguards ED-1. Accordingly, the Safeguards Task Force plans to liaise closely and coordinate with the Structure Task Force in advance of the June 2016 IESBA meetings.

- (b) A review of the CF approach to independence, in light of the proposed revised description of the CF in Phase I;
- (c) Consideration of whether there is a need for alignment to the requirements and application material in ISA 230⁶ with respect to documentation of safeguards in the context of audits of financial statements; and
- (d) An update of other areas in the Code based on new terminology or revised concepts developed under the first phase of the project.

Conforming Amendments to Near-final Proposals

- 10. The Task Force has determined that limited conforming amendments may be needed to the revised provisions on Part C – Professional Accountants In Business (Part C) the IESBA approved in December 2015 (i.e., Phase I work only),⁷ and the near-final proposals regarding Long Association (LA) to reflect new terminology or revised concepts in Safeguards ED-1. The Task Force is working closely with those Task Forces as well as the Structure Task Force, and is planning to consider the need for safeguards-specific proposed conforming amendments. The Task Force is aiming to present safeguards-specific conforming amendments for IESBA consideration at the June 2016 meeting.
- 11. As part of Phase II of the Safeguards project, the Task Force anticipates that the IESBA will also:
 - (a) Consider, as appropriate, the unique challenges faced by small and medium practices (SMPs) in employing safeguards.
 - (b) Consider whether additional guidance is needed in the Code to explain the differences in the evaluation of whether a threat is at an acceptable level for a public interest entity (PIE) and an entity that is not a PIE.
 - (c) Engage with stakeholders, including regulators, national standards setters, forum of firms and others, to obtain their input.

RECAP OF PHASE I

- ✓ Clarification of the conceptual framework
- ✓ Enhanced description of “reasonable and informed third party”
- ✓ Revised definition of “acceptable level”
- ✓ Revised description of “safeguards”
- ✓ Enhanced guidance for identifying, evaluating and addressing threats
- ✓ Enhanced guidance on re-evaluating threats
- ✓ New requirement for overall assessment (‘step-back’)
- ✓ Improved examples of types of threats and safeguards

⁶ ISA 230, *Audit Documentation*

⁷ Some stakeholders have suggested that the IESBA should further elaborate on the application of the CF for professional accountants in business. The Task Force will consider this suggestion further as part of a possible third phase of the Safeguards project.

B. Matters Addressed in This Paper

12. This paper:
- (a) Describes the Task Force's rationale for the significant changes to the section of the proposed restructured Code pertaining to the application of the CF to independence (i.e., proposed revisions to certain paragraphs in proposed Section 400 of Structure ED-1) (see **Agenda Item B-1**).
 - (b) Includes a summary of the key issues identified by the Task Force and sets out a proposed way forward with respect to the review of safeguards in the NAS section of the Code.
 - (c) Addresses other general matters relevant to developing proposals as part of Phase II of the Safeguards project.

Alignment and Coordination with the Structure Task Force

13. The Task Force continues to work in close coordination with the Structure Task Force. The Task Force believes that its proposed revisions are drafted in the format and language of the proposed restructured Code.

C. Proposed Revisions – Application of CF to Independence for Audits and Review Engagements

14. Structure ED-1 includes proposed revisions to restructure the section of the extant Code titled, *Application of the Conceptual Framework Approach to Independence* as proposed Section 400 (shaded in gray and italicized text). **Agenda Item B-1** includes proposed revisions pertaining to safeguards and is marked to show changes to the proposals in Section 400 of Structure ED-1, many of which are shaded in gray and italicized (paragraphs 290.1–290.14 of the extant Code). **Agenda Item B-2** is a clean version of the Task Force's proposals.

Linkage Between Independence and the Fundamental Principles

15. In finalizing its December 2015 EDs, the IESBA agreed that subsequent sections of the proposed restructured Code would build on, but not repeat the requirements and application material in proposed Section 120. The IESBA was of the view that it was important to make the CF more prominent in the proposed restructured Code.⁸ The Task Force applied this approach in developing its proposals in Section 300 of the December 2015 EDs, but identified challenges using this approach to develop proposed revisions to Section 400. This is because the topic of "independence," addressed in proposed Section 400, is not explicitly mentioned within the fundamental principles in the proposed restructured Code. Also, proposed Section 120 does not include a reference to the in C1 and C2, or proposed Section 400.

⁸ The CF is intended to assist professional accountants identify, evaluate and address threats to compliance with the fundamental principles.

16. Consequently, the Task Force believes that there is a need to have clarity of the linkage between independence and the fundamental principles. The IESBA included the following proposals in Structure ED-1 to clarify the linkage between independence and the fundamental principles:⁹

...In the case of audits, reviews and other assurance engagements, the Code sets out international independence standards established by the application of the fundamental principle of objectivity to these engagements...”

“Independence is a measure of objectivity, both in mind and appearance, which is applied to audit engagements. It enables a firm to express, and be seen to express, an objective conclusion when performing such engagements. It is in the public interest and required by the Code that members of audit teams, firms and network firms be independent of audit clients. C1 sets out requirements and application material on maintaining independence when performing audit engagements. (See also paragraph 400.7 regarding references to “firm.”)

“Independence comprises:

- (a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism.
- (b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm’s, or a member of the audit or assurance team’s, integrity, objectivity or professional skepticism has been compromised.”

17. The Task Force believes that the Code would benefit from additional application material to explain why the CF for compliance with the fundamental principles in proposed Section 120 is relevant to independence, and should be applied to identify, evaluate and address threats to independence.

Task Force Recommendations

18. The Task Force liaised with the Structure Task Force and re-affirmed the IESBA’s view that the CF (i.e., proposed Section 120 of the December 2015 EDs) should remain the focal point of the Code and that the International Independence Standards in Parts C1 and C2 of the restructured Code, including proposed Section 400, should not be promulgated as a stand-alone document.
19. Other than where a matter is of such significance as to require reinforcement and on an exceptional basis, both Task Forces continue to be of the view that, in principle, only incremental requirements and application material that build on the requirements and application material in Section 120 should be introduced elsewhere in the Code.
20. The Task Forces also agreed that it would be useful if proposed Section 120 cross-referred to other sections of the Code, including C1 and C2. Accordingly, the Task Forces jointly determined that it

⁹ See paragraphs 3 of the Guide to the proposed restructured Code, and paragraphs 112.A1 and 400.1–400.2 of Structure ED-1. Those paragraphs are adapted from paragraphs 290.1 and 290.4 of the extant Code. Also relevant is proposed paragraph 400.1 of Structure ED-1.

would be useful to introduce a new paragraph in proposed Section 120 of the December 2015 EDs as follows:

The Conceptual Framework

Introduction

120.1...

120.2....

120.3 A1 Professional accountants are required to apply the conceptual framework in order to comply with the fundamental principles in a wide variety of roles and circumstances. Parts B, *Professional Accountants in Business* and Part C *Professional Accountants in Public Practice*, including the International Independence Standards in C1 and C2, set out additional requirements and application material for applying the conceptual framework.

Requirements and Application Material

R120.3.....

Issue for Further Task Force Consideration

21. The Task Force believes that the proposed new text in paragraph 13 above provides an explicit link between Sections 120 and 400 and helps to address the initial drafting challenges that it experienced (see paragraph 8 above). However, the Task Force seeks to be informed by the further deliberations of the Structure Task Force and the IESBA about whether paragraphs 400.1 and 400.2 of Structure ED-1 could be enhanced to further clarify the linkage between independence and the fundamental principles.

Requirements and Application Material for Identifying, Evaluating and Addressing Threats to Independence

22. The Task Force believes its revised proposals in paragraphs R400.10–R400.15 of **Agenda Item B-1** achieve the right balance in terms of the alignment needed between the provisions in Sections 120 and 400, and the amount of emphasis on independence needed in the Code. The Task Force's proposals:
- (a) Retain the overarching requirement set out in paragraph R400.9 of Structure ED-1 to apply the CF when identifying, evaluating and addressing threats to independence in relation to an audit engagement (see paragraph R400.10).
 - (b) Introduce new application material to explain that the threats to independence are similar to the threats to the fundamental principles and fall into the five categories of threats that are described in paragraph 120.5A2 of the proposed restructured Code (see paragraph 400.10 A1).
 - (c) Explain, in new application material, the importance of the reasonable and informed third party test. The Task Force believes that this test is of such significance to independence that it warrants an explicit reinforcement in proposed Section 400 (see paragraph 400.10 A2).
 - (d) Establish stand-alone requirements for firms to identify, evaluate, address and re-evaluate threats to independence. Similarly, the Task Force believes it is important to establish a stand-

alone requirement for the firm to perform an overall assessment (i.e., a step-back requirement) of threats to independence (see paragraphs R400.11, R400.13, R400.14 and R400.15).

- (e) Include new application material to support the above overarching requirement to explain that threats to independence are similar to threats to compliance with the fundamental principles. The Task Force believes that this explanation (see paragraph 400.10A1):
 - (i) Provides useful context about how threats to independence are created; it also emphasizes that threats to independence can arise from any one of the five threats to the fundamental principles; and
 - (ii) Helps to explain why the CF to compliance with the fundamental principles in proposed Section 120 is relevant to independence, and should be applied to identify, evaluate and address threats to independence.
 - (f) Include new application material for evaluating threats to independence. This new application material:
 - (i) Explains that the term “acceptable level” in the context of independence is a level at which a reasonable and informed third party would likely conclude that a firm is independent in accordance with the Code. The Task Force plans for this further explanation to be added to the proposed glossary definition of “acceptable level”¹⁰ (i.e., paragraph 400.12 A1).
 - (ii) Builds on the application material in paragraph 300.2 A3 of Safeguards ED-1 and is intended to remind firms that the level of a threat to independence is impacted by whether or not an audit client is a public interest entity (see paragraph 400.12 A2).
23. The Task Force re-affirmed the position taken by the IESBA in Structure ED-1¹¹ and paragraph 19 of the accompanying Explanatory Memorandum, and agreed that the ultimate responsibility for applying the CF is that of the firm. Accordingly, the requirements and application material for identifying, evaluating and addressing threats to independence (i.e., the CF for independence) in proposed Section 400 have all been directed at the firm (see **Agenda Item B-1**). The Task Force looks to be informed by the deliberations and decisions of the Structure Task Force and IESBA about the proposed paragraph R400.9 of Structure ED-1 before concluding whether further changes are needed.

Communicating With Those Charged with Governance (TCWG)

24. The extant Code encourages, but does not require, regular communication between the firm and TCWG regarding relationships and other matters that might, in the firm’s opinion, reasonably bear on

¹⁰ The proposed glossary definition of “acceptable level” is also included in paragraph 120.6A of Safeguards ED-1.

¹¹ Paragraph 400.7 of Structure ED-1 states that: “Firms are required by International Standards on Quality Control (ISQCs) to establish policies and procedures designed to provide them with reasonable assurance that independence is maintained when required by relevant ethical requirements. International Standards on Auditing (ISAs) establish responsibilities for engagement partners and engagement teams. Certain responsibilities within a firm depend on its size, structure and organization. Many of the provisions of C1 do not prescribe the specific responsibility of individuals within the firm for actions related to independence. Although firms and professional accountants within those firms each have responsibilities for compliance, for ease of reference, many of the provisions of C1 refer to “firm,” even if the main responsibility rests with an individual within the firm.”

independence.¹² The International Auditing and Assurance Standards Board's (IAASB's) International Standards on Auditing (ISAs) include requirements for auditors of listed entities to communicate with TCWG about independence matters.¹³ For example, ISA 260 (Revised):

- (a) Requires auditors of listed entities to communicate with TCWG “the related safeguards that have been applied to eliminate threats to independence or reduce them to an acceptable level.”
- (b) Includes application material indicating that auditor communication with TCWG about auditor independence may also be appropriate in the case of some other than listed entities besides listed entities, including entities that may be of significant public interest (e.g., financial institutions such as banks, insurance companies and pensions funds, and other entities such as charities). The application material also acknowledges and describes certain situations when communications about independence with TCWG may not be relevant.

Task Force Recommendations

- 25. The Task Force believes that effective auditor communication with TCWG will increase transparency about how auditors identify, evaluate and address threats to independence and compliance with the fundamental principles more broadly. Reflecting on its enhancements to the CF for independence, and the CF more broadly, the Task Force believes that there is merit to requiring, rather than encouraging, auditor communication with TCWG when there are relationships or other matters that might, in the firm's opinion, reasonably bear on independence. The Task Force also believes that the provisions in the Code pertaining to auditor communication with TCWG about independence and the relevant IAASB requirements in ISA 260 (Revised) should be aligned. The Task Force deliberated:
 - (a) The appropriateness of having such a requirement for listed entities only as is currently required in the ISAs, and questioned whether it should be for PIEs or all entities; and
 - (b) The value of including such requirements in the Code if they are already addressed in the ISAs.
- 26. The Task Force believes that establishing more robust requirements for auditor communication with TCWG in the Code might be responsive to stakeholders, including regulators. TCWG play an important role in promoting confidence that an independent audit has been conducted. TCWG may also have an explicit responsibility over auditor independence under their terms of reference, or as required by law or regulation. Good and transparent auditor communication with TCWG facilitates the effective discharging by TCWG of their roles and responsibilities with respect to auditor independence. The Task Force is also considering how the Code could contain enhanced requirements pertaining to auditor communication with TCWG about NAS that is provided to an audit client (see further discussion below).

Other Issues and Recommendations

Documentation

- 27. The Task Force has proposed specific revisions to the proposals in Structure ED-1 that are intended to strengthen the requirements for firms to document their conclusions about how they have complied

¹² Section 290, *Independence – Audit and Review Engagements*, paragraph 28. Paragraphs 290.34–290.36 of the extant Code require communication with TCWG about other matters, including when there is a breach of a provision in Section 290 or 291 of the extant Code.

¹³ See ISA 260 (Revised), *Communication with Those Charged with Governance*, paragraphs 17 and A29–A32

with the independence requirements (see paragraph R402).

Engagement Period

28. The Task Force identified some paragraphs to which changes of a conforming nature are needed in light of the Safeguards project. Those proposed changes are shown in paragraphs R400.18–R400.19.

Matters for CAG Consideration

1. Representatives are asked whether they agree with the Task Force's proposed revisions to Section 400, including the manner in which reference is made to proposed Section 120.
2. Representatives are asked for views about the other matters discussed in this section of the paper, including whether they agree with the Task Force's proposal with respect to the need for a new paragraph in proposed Section 120.
3. Representatives are asked for views about the Task Force's proposal for enhancing auditor communication with TCWG about independence matters in the Code.

D. NAS

Background

29. The provision of NAS may create threats to the independence of the firm or members of the audit team. Paragraphs 290.154 to 290.216 of the extant Code establish requirements for, and provide guidance to, professional accountants in public practice who provide NAS to audit clients. The Task Force took into account the April 2015 changes to the NAS section of the Code that:¹⁴
- Prohibit auditors from assuming management responsibility when providing NAS to audit clients;
 - Remove provisions that permitted an audit firm to provide certain bookkeeping and taxation services to PIE audit clients in emergency situations;
 - Introduce new and clarified application material regarding what constitutes management responsibility; and
 - Clarify guidance regarding the concept of "routine or mechanical" services relating to the preparation of accounting records and financial statements for audit clients that are not PIEs.

Approach for Considering Revisions Pertaining to Safeguards in the NAS Section of the Extant Code

30. The Task Force initially planned on leveraging the November/ December 2015 IESBA agenda materials that included a draft of the proposed restructured NAS section of the extant Code. Under this approach, the Task Force developed proposed revisions to the NAS section of the extant Code that:
- (a) Aligned to the changes in Safeguards ED-1; and

¹⁴ Those changes will be effective on April 15, 2016, with early adoption permitted, and are intended to enhance the independence provisions in the Code.

- (b) Responded to the specific concerns that were raised by stakeholders, in particular regulators.
31. At first, the Task Force was of the view that the changes to the NAS provisions issued in April 2015 should be limited and be strictly of a conforming nature. Reflecting on its proposals that resulted from applying the approach described immediately above, the Task Force determined that its proposed revisions to the NAS section of the extant Code did not yet achieve the spirit of what the IESBA and its stakeholders originally envisioned with respect to the review of safeguards pertaining to NAS in the extant Code. Consequently, the Task Force is planning to undertake a more holistic review that would involve taking a "fresh look" at how the NAS section of the extant Code could be enhanced with respect to safeguards.
32. The Task Force plans to present its NAS proposals in a restructured format for a first read at the June 2016 IESBA meeting. With respect to restructuring, the Task Force plans to continually liaise and coordinate with the Structure Task Force in finalizing its proposals in order to be consistent with the formatting and drafting conventions of the proposed restructured Code. The Safeguards Task Force believes that a revised NAS section of the extant Code should:
- (a) Prominently feature overarching principles that would be applicable in providing all NAS to an audit client; and
- (b) Include a stronger link between the threats to independence and compliance with the fundamental principles that are created from providing a particular NAS to guidance about how this threat should be addressed (for example, by indicating the specific prohibitions and safeguards that correspond to the specific threat).
33. To facilitate its work, the Task Force performed an analysis of the threats, safeguards and prohibitions in the NAS section of the extant Code, focusing on the specific threats to independence that are created from providing a NAS to an audit client. This analysis, together with the Task Force's initial proposal, forms the basis for the issues and recommendations discussed below.

Issues and Recommendations Pertaining to NAS

NAS Addressed in the Extant Code

34. The Task Force observed that the NAS section of the extant Code deals with threats to independence arising from a self-interest, self-review, or advocacy threat. However, the Task Force noted that threats to independence may also arise as a result of a familiarity or intimidation threat. The Appendix to this paper includes an overview of the matters addressed in the NAS section of the extant Code.

Principles for Identifying, Evaluating and Addressing Threats to Independence Created From Providing a NAS to an Audit Client

35. The Task Force is of the view that certain overarching principles are relevant to, and may be useful in, the consideration of a framework that firms may apply to determine whether to provide a NAS to an audit client. Drawing from existing prohibitions that are addressed as part of specific NAS topics within the extant Code, the Task Force is of the view that a firm should not provide a NAS to an audit client if:
- (a) The NAS involves assuming management responsibilities;
- (b) The NAS creates a self-review threat and will likely have a material effect on the financial statements on which the firm will express an opinion;

- (c) When the NAS depends on a particular accounting treatment or presentation in the financial statements and the audit team has reasonable doubt as to the appropriateness of the related accounting treatment or presentation of the accounting entries under the relevant financial reporting framework;
 - (d) The NAS will contribute to a significant component of the internal control over financial reporting or will form part of information that is significant to the client's accounting records or financial statements on which the firm will express an opinion;
 - (e) The NAS causes the firm to act in an advocacy role that involves resolving a dispute or litigation when the amounts involved are material to the financial statements on which the firm will express an opinion; and
 - (f) The NAS involves promoting, dealing in, or underwriting an audit client's shares.
36. The Task Force is of the view that there is a direct link between the above principles and the threats to the independence created by providing each NAS. The Task Force believes that the Code will be enhanced if it is supplemented with a clear set of principles and criteria to determine when the level of threats to independence is acceptable.

Management Responsibilities

37. Based on its review of the provisions in paragraphs 290.159–290.162 of the extant Code that deal with management responsibility, the Task Force concluded that management responsibilities are rarely provided as a NAS by itself, but rather as a possible component of all types of NAS. As a result, the Task Force is of the view that the requirements related to management activities should be the prerequisites for providing any NAS to an audit client.
38. Accordingly, the Task Force plans to rename the title of subsection 601, "Management Responsibilities" to "Prerequisites to Providing Non-assurance Services to An Audit Client."

Identifying, Evaluating and Addressing Threats to Independence and Compliance with the Fundamental Principles

Identifying and Evaluating Threats

39. Based on its review of the extant Code, the Task Force observed that some, but not all, of the NAS topics in the Code include guidance for identifying and evaluating the threats created by providing a NAS service. For example, the Task Force noted that the sections of the extant Code that address valuation services, some taxation, litigation support, legal, and corporate finance services include such guidance. However, the provisions pertaining to information technology or recruiting services do not.
40. The Task Force is of the view that the requirements and application material in the CF are relevant to a firm's identification and evaluation of threats created by providing a NAS to an audit client. Accordingly, the Task Force is planning to establish an overarching requirement within the NAS section of the Code requiring firms to apply the CF set out in proposed Section 120 as well as the provisions in proposed Section 400.

Materiality

41. Leveraging a previously released IESBA Staff Q&A on the topic of materiality, the Task Force is

exploring whether additional application material can be added to the Code to explain how firms should consider materiality and significance (i.e., quantitative and qualitative considerations) in determining the level of a threat created by providing a NAS to an audit client. The Task Force agreed that it would not be appropriate to develop a new description of materiality beyond what is already included in the accounting and auditing standards. Instead, the Task Force believes it would be more appropriate to build on the description included in existing standards.

Addressing Threats, Including Examples of Safeguards

42. The Task Force notes that the Code provides examples of safeguards that might address threats created by providing a NAS. The Task Force believes that there is merit to retaining those examples. Generally, the Task Force believes that examples of safeguards that might address threats to independence are as follows:
- (a) Not including individuals who provided the NAS as audit team members (self-review).
 - (b) Having another professional accountant review the audit and NAS work as appropriate (self-review, self-interest and familiarity).
 - (c) Engaging another firm to evaluate the results of the NAS (self-review, self-interest, familiarity and advocacy).
 - (d) Having another firm re-perform the NAS to the extent necessary to enable that other firm to take responsibility for the service (self-review, self-interest, familiarity and advocacy).
43. In general, the Task Force observed that the examples of safeguards included within each NAS is covered by those listed above. Consequently, the Task Force plans to consider whether it can streamline, and eliminate any duplication within, the examples of NAS-specific safeguards in the extant Code.

NAS Not Addressed in the Code

44. The extant Code notes that “new developments in business, the evolution of financial markets and changes in information technology make it impossible to draw up an all-inclusive list of the NAS that might be provided to an audit client.” The Task Force considered whether there is merit to:
- (a) Define a NAS. The Task Force observed that the proposed glossary in Structure ED-1 includes a definition of the term “assurance engagement” but does not define the term “non-assurance service.” The Task Force concluded that given the evolving nature of NAS, in particular in the international context, it would be preferable not to include a definition of a NAS in the Code; and
 - (b) Address in a general manner those NAS that are provided to audit clients but are not addressed in the extant Code. The Task Force is of the view that its planned approach for revising the NAS section of the Code, described above, will address this issue.

Communicating With TCWG About NAS Provided to An Audit Client

45. The Task Force revisited the options set out in the June/July 2015 IESBA agenda material regarding how a firm should involve TCWG in deciding whether to provide NAS to an audit client. Those options were as follows:
- (a) Informing TCWG of the NAS that is provided to an audit client.

- (b) Obtaining the concurrence of TCWG regarding the provision of a NAS to an audit client.
 - (c) Obtaining pre-approval from TCWG regarding the provision of a NAS to an audit client.
46. At the June/July 2015 meeting, the IESBA agreed that depending on the circumstances, each option or a combination of all of the above options may be appropriate. The IESBA also agreed that the application of professional judgment would be necessary to determine which option would be appropriate. The IESBA was also of the view that relevant factors to consider would include: the size of NAS; the expected duration of the NAS; and whether there are relevant laws and regulations pertaining to NAS that apply within the jurisdiction where the NAS would be provided to an audit client.

Task Force Recommendations

47. The Task Force is exploring whether there is merit to requiring that firms consider when and how to communicate with TCWG about the provision of NAS to an audit client. Such a new requirement might be supported by new application material that could explain that such auditor communication with TCWG would:
- (a) Inform TCWG of the NAS that is provided to the audit client; and
 - (b) Encompass obtaining pre-approval of TCWG, or the concurrence of TCWG, regarding the provision of a NAS to an audit client.
48. The Task Force also plans to consider the merits of adding new application material to the Code to:
- (a) Introduce factors such as the following to assist firms in determining what to communicate with TCWG:
 - (i) The size or nature of the NAS.
 - (ii) The expected duration of the NAS.
 - (iii) The size or nature of the NAS fee.
 - (b) Provide a list of examples of matters that a firm might deem appropriate to communicate with TCWG:
 - (i) A description of the NAS provided during the period covered by the financial statements for audit and NAS provided by the firm and network firms to the entity and components controlled by the entity.
 - (ii) The nature and amount of the fees for the above NAS.
 - (iii) The steps taken by management to avoid the risk of the firm assuming a management responsibility.
 - (iv) The safeguards put in place to eliminate the threat or reduce it to an acceptable level.
 - (v) If necessary, any consultation with other individuals within the firm or network or with a professional body.
 - (vi) A conclusion that the firm is independent.

Other Issues

Differential Requirements for PIEs and Non-PIEs

49. The Explanatory Memorandum to Safeguards ED-1 signaled that the IESBA would continue to consider whether additional guidance is needed in the Code to explain the differences in the evaluation of whether a threat is at an acceptable level for a PIE and a non-PIE. The Task Force plans to consider this in conjunction with its plans to establish overarching principles regarding the provision of NAS to an audit client (as discussed above).

Description of Familiarity Threat

50. Respondents to the August 2014 Long Association ED suggested that the IESBA consider whether the description of "familiarity threat" should be expanded to include "financial information." The Explanatory Memorandum to the February 2016 Long Association re-Exposure Draft, *Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client* (LA Re-ED) states that "... despite the current definition of a familiarity threat in the Code, it is reasonable to conclude that a familiarity threat may also be created as a result of an individual's long association with the financial information which forms the basis of the financial statements. The individual may become too accepting of information he or she has seen before, which may potentially cause the individual to become less skeptical than he or she would have been otherwise." It also noted that the IESBA would separately consider whether there is a need to clarify the definition of familiarity threat in the Code. Accordingly, as part of its Phase II work, the Task Force plans to further consider this matter.
51. In addition, the Task Force plans to consider whether some of the principles set out in the LA-Re-ED proposals might be relevant to identifying, evaluating and addressing threats created from providing NAS to an audit client.

Matters for CAG Consideration

4. Representatives are asked for views about the issues identified and the Task Force's planned approach for revising the NAS section of the extant Code.
5. Representatives are asked to share any further comments on matters relevant to Phase II of the Safeguards project.

Coordination with Other Task Forces, Including the Structure Task Forces

52. As noted above, the Task Force continues to work closely with the Structure Task Force. As noted above, the Task Force is also planning to work closely with the Long Association and Part C Task Forces to provide input about whether safeguard-specific conforming amendments are needed. The Task Force plans to consider this matter further at its March 2016 meeting.
53. For purposes of the March 2016 IESBA meeting, the restructured paragraphs in the Long Association and Part C agenda material to which safeguards-specific conforming amendments might be needed will be shaded in gray.

Plans for Engagement and Outreach

54. Task Force members have highlighted the need for outreach on its proposals in advance of finalizing Phase II. The Task Force is of the view that targeted discussions with certain stakeholder groups, in particular regulators and audit oversight authorities, firms, SMPs and national standard setters, will assist in refining the proposals.
55. Opportunities for outreach in advance of the June 2016 IESBA meeting include planned discussions with the:
- IFAC SMP Committee (March 2016).
 - Forum of Firms (May 2016).
 - IESBA-NSS Liaison Group (June 2016).

Liaison With the IAASB

56. The Task Force is of the view that discussions with the IAASB will be necessary to explain how the proposals pertaining to safeguards might impact the ISAs, in particular ISA 260 (Revised). The Task Force believes that it will be necessary for the terminology and concepts in ISA 260 (Revised) to be aligned with the proposed new and revised provisions in the Safeguards ED. For example:
- The references to “safeguards created by the profession, legislation or regulation, safeguards within the entity, and safeguards within the firm’s own systems and procedures” in ISA 26015 will need to be deleted.
 - The use of the phrase “...safeguards that have been applied to eliminate threats...”¹⁶ in ISA 260 will need to align with the new concepts in proposed Section 120 pertaining to addressing threats to compliance with the fundamental principles, taking into account the proposed new description of safeguards.

Material Presented

Agenda Item B-1	Safeguards Phase II – Proposed Revisions to International Independence Standards C1 – Independence – Audit and Review Engagements (Sections 400–404) [Marked from Structure ED]
Agenda Item B-2	Safeguards Phase II – Proposed Revisions to International Independence Standards C1 – Independence – Audit and Review Engagements (Sections 400–404) [Clean]

Material Presented – FOR IESBA CAG REFERENCE PURPOSES ONLY

Safeguards Exposure Draft, *Proposed Revisions Pertaining to Safeguards in the Code—Phase 1 (ED-1)*

<http://www.ifac.org/publications-resources/proposed-revisions-pertaining-safeguards-code-phase-1>

¹⁵ ISA 260 (Revised), paragraphs 17(b)

¹⁶ ISA 260 (Revised), paragraph A30(b)

Appendix 1

The NAS Section of the Extant Code

1. The extant Code addresses the following within the NAS section:
 - Introduction and general requirements (paragraphs 290.154–290.158)
 - Management responsibilities (paragraphs 290.159–290.162 as amended)
 - Administrative services (paragraphs 290.163 as amended)
 - Preparing accounting records and financial statements (paragraphs 290.164–290.170 as amended)
 - Valuation services (paragraphs 290.172–290.177);
 - Taxation services, including (paragraphs 290.178–290.179):
 - Tax return preparation (paragraphs 290.180)
 - Tax calculations for the purpose of preparing accounting entries (paragraphs 290.181–290.182 as amended)
 - Tax planning and other tax advisory services (paragraphs 290.184–290.188)
 - Assistance in resolution of tax disputes (paragraphs 290.189–290.191)
 - Internal audit services (paragraphs 290.192–290.197)
 - Information technology (IT) services (paragraphs 290.198–290.203)
 - Litigation support services (paragraphs 290.204–290.205)
 - Legal services (paragraphs 290.206–290.210)
 - Recruiting services (paragraphs 290.211–290.212)
 - Corporate finance services (paragraphs 290.213–290.216)

Appendix 2

Project History

Project: Safeguards

Summary

	CAG Meeting	IESBA Meeting
Project commencement		January 2015
Development of proposed international pronouncement (up to exposure)	March 2015 September 2015	April 2015 June/July 2015 September 2015 November/ December 2015

CAG Discussions: Detailed References

Project Commencement	<u>March 2015</u> See IESBA CAG meeting material here (see Agenda Items D, D-1, D-2, D-3 and D-4) and CAG meeting minutes (see section D).
Development of proposed international pronouncement (up to exposure)	<u>September 2015</u> See IESBA CAG meeting material here (see Agenda Items E and E-1) and CAG meeting minutes at Agenda Item A (see Section E). <u>March 2016</u> See Agenda Items B-1 and B-2