

Safeguards Phase 2—NAS Issues and TF Proposals

A. Introduction

1. At their March 2016 meetings, the IESBA and IESBA Consultative Advisory Group (CAG) provided input on the Task Force (TF) preliminary proposals with respect to Safeguards Phase 2. Phase 2 of the Safeguards project includes proposed revisions to enhance safeguards in the non-assurance services (NAS) section of the extant Code.
2. At its June 2016 meeting, the IESBA considered an [initial draft](#) of Section 600, *Provision of Non-assurance Services to an Audit Client*. IESBA generally supported most of the TF's proposals but suggested certain refinements to the project scope.¹ For example, IESBA concluded that the TF's preliminary proposals to enhance the provisions in the Code related to those charged with governance (TCWG) and documentation should be deferred because they require a broader consideration, including liaising with the IAASB.

Matters Addressed in this Paper

3. This paper summarizes the significant revisions that have been made to the NAS section of the extant Code for audit and review engagements.² It also explains the TF's rationale for its proposals. The TF's proposals, set out in **Agenda Item C-5**, will be considered by IESBA at its September 2016 meeting. Agenda Item 2-H to the September 2016 IESBA meeting materials is a mapping table that compares the TF's proposals to the NAS provisions in the extant Code and is available at the IESBA [website](#).
4. This paper is organized as follows:
 - (a) Overview of NAS enhancements;
 - (b) Significance of the threat, "level of threat" and materiality;
 - (c) Other specific revisions by NAS type; and
 - (d) Matters for future IESBA consideration.

B. Overview of NAS Enhancements

5. The TF's proposals incorporate the feedback from the June 2016 IESBA deliberations including its conclusions about the proposed revisions to the December 2015 Exposure Drafts, *Proposed Revisions Pertaining to Safeguards in the Code—Phase 1* (Safeguards ED-1) and *Improving the Structure of the Code of Ethics for Professional Accountants* (Structure ED-1) in response to feedback from respondents.

¹ The January 2015 Safeguards project proposal notes that the project is intended to evaluate and make recommendations on the clarity, appropriateness and effectiveness of the current overview of safeguards in Sections 100, *Introduction and Fundamental Principles* and 200, *Introduction (Professional Accountants in Public Practice)* of the extant Code and those safeguards that pertain to NAS in Section 290, *Independence – Audit and Review Engagements* of the Code. Appendix 1 to this paper includes an overview of the specific matters set out in the project proposal and an update of the TF's/IESBA's activities with respect to those matters.

² The TF has determined that consequential amendments will need to be made to extant paragraphs 291.138–291.148, *Provision of Non-assurance Services to an Assurance Client* of Section 291, *Independence – Other Assurance Engagements*. The TF plans to undertake this work at its October 2016 meeting, taking into account the input on Section 600 that is provided during the September 2016 IESBA and CAG meetings.

Agenda Items C-1 and B1 include a further discussion of the respondents' feedback on Safeguards ED-1 and Structure ED-1.

6. Phase 2 of the Safeguards project is another step in the journey to enhancing the NAS section of the extant Code. The TF's proposals build on what is already a more robust set of NAS requirements and application material in the Code as a result of IESBA's recently completed and ongoing projects. The TF's proposals:
- (a) Retains the already effective, [*Changes to the Code Addressing Certain Non-Assurance Services Provisions for Audit and Assurance Clients*](#).³ Limited conforming amendments have been made as appropriate to certain requirements and application material. Those changes are not intended to change the meaning of the April 2015 NAS changes, but rather are intended to better align to conclusions reached in Phase 1 of the Structure of the Code and Safeguards projects.
 - (b) Are drafted using the new format and drafting conventions developed by the Structure TF.⁴ With this restructured format, the TF believes that the NAS provisions are clearer, more understandable and enforceable and will facilitate consistent application and effective implementation.
 - (c) Include new introductory material that clarifies that firms and network firms are to:⁵
 - Comply with the fundamental principles;
 - Be independent; and
 - Apply the conceptual framework (CF) to independence when providing NAS to audit clients. Safeguards ED-1 include enhanced and more explicit requirements and application material that already strengthen the CF. For example, paragraph R120.8 of **Agenda Item C-2** include an enhanced requirement for addressing threats. This enhanced requirement makes it clear that applying safeguards is not the only way to address a threat.

Enhanced General Provisions

7. The TF's provided new general provisions to identify, evaluate and address threats created by accepting and providing NAS to audit clients, in particular when a NAS is not explicitly referenced in the Code.
8. The more robust set of general provisions:
- (a) Emphasize that providing NAS to audit clients might create threats to compliance with the fundamental principles – integrity, objectivity, professional competence and due care, confidentiality

³ In April 2015, IESBA approved NAS changes that became effective in April 15, 2016. Those changes:

- 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.

⁴ The TF leveraged the initial draft of the restructured NAS section of the extant Code that formed part in [*Agenda Item 3-H*](#) to the November/ December 2015 IESBA meeting agenda materials as a starting point for developing its proposals

⁵ The introductory text in paragraphs 600.2 of **Agenda Item C-5** and each subsection that follows was developed in conjunction with the Structure TF.

and professional behavior – as well as threats to independence.

- (b) Explain that the subsections that follow paragraphs 600.1–R600.11 set out requirements and application material that are relevant to specific types of NAS. It also indicates that in some cases, those requirements prohibit a firm or network firm from providing a NAS to an audit client because there can be no safeguards to eliminate the threats created or reduce them to an acceptable level. This latter point is further emphasized, when applicable, in the introduction to the subsections.
- (c) Provide new application material for evaluating and addressing threats created by providing any NAS to an audit client, including those not specified in the Code.
- (d) Include new application material to explain materiality in relation to an audit client's financial statements.

Considerations for When a Firm or Network Firm Provide Multiple NAS to an Audit Client

- 9. The TF's proposals build on paragraph 120.6 A1 of Safeguards ED-1 in **Agenda Item C-2**, and include new application material to acknowledge that a firm or network firm might provide multiple NAS to an audit client. The new application material explains that applying the CF requires that the firm or network firm consider any combined effect of threats created by providing other NAS to the audit client (see paragraph 600.4 A1).

Considerations for Avoiding the Assumption of Management's Responsibilities

- 10. The TF's proposals emphasize that as a prerequisite for providing any NAS to an audit client, the firm or network firm cannot assume management's responsibility for the audit client. In this regard, the TF believes that the requirements and application material that formed part of a stand-alone section titled, "Management's Responsibilities" in the extant Code, should now form part of the general provisions.
- 11. The TF continues to believe that it is appropriate for firms and network firms to provide advice and recommendations to assist management of an audit client in discharging its responsibilities and has retained those related requirements and application material in paragraphs R600.10–R600.11.

Types of NAS and Use of Subsections

- 12. The TF's proposals do not deal with the permissibility of NAS. Accordingly, the types of NAS services that are permitted in the extant Code are retained. However, in the case of recruiting services, the TF concluded that some requirements that are applicable for entities that are public interest entities (PIEs) in the extant Code should be extended more broadly (see paragraphs 38–40 of this paper).
- 13. In close coordination with the Structure TF, the TF agreed to use subsections to deal with each type of NAS service. Accordingly, the contents of each type of NAS that is addressed in the extant Code has been reorganized in a stand-alone subsection (Subsections 602–611) that:
 - Describes the type of NAS;
 - Indicates the type of threat created; and
 - Provides general requirements and application material to assist in evaluating and addressing specific threats created by providing the specific NAS to audit clients.

Ordering of Requirements and Application Material

- 14. Generally, and consistent with the approach taken in Structure ED-1, the requirements in the TF's

proposals appear before the application material. However, in some cases, when a subsection includes prohibitions for:

- (a) Audit clients that are not PIEs, and
- (b) Audit clients that are PIEs;

the ordering of the provisions in each subsection is as follows:

- (i) Application material for applying the CF to independence (i.e., specific examples of factors to help firms and network firms evaluate the level of a threat; and examples of actions that might be safeguards to address the specific type of threat created by providing a NAS to an audit client.
- (ii) Requirements and application material for audit clients that are not PIEs.
- (iii) Requirements and application material for audit clients that are PIEs.

The TF believes that this ordering follows the logic approach set out in the CF set out in Section 120.⁶

Explicit Link between Threats and Safeguards

15. The TF's proposals improve the safeguards in the NAS section of the extant Code and incorporate several suggestions received from IESBA's stakeholders, including respondents to the October 2014 Structure Consultation Paper, *Improving the Structure of the IESBA Code* (CP) and the October 2014, Exposure Draft, *Proposed Changes to Certain Provisions of the Code Addressing Non-Assurance Services for Audit Clients*.
16. The TF's proposals retain many of the "examples of safeguards" in the NAS section of the extant Code but clarify that they are "actions that might be safeguards to address the specific threat created by providing the specific type of NAS. In doing so the TF seeks to refocus firms and network firms to be mindful of other actions that might be more appropriate depending on the facts and circumstances to address the threat(s). The CF indicates that other specific actions that might address threats are (see paragraph R120.8 of **Agenda Item C-2**):
 - (a) Eliminating the circumstance, including interests or relationships, that is creating the threat(s); or
 - (b) Declining or ending the specific professional activity.

Matter for CAG Consideration

1. Representatives are asked to consider the matters in paragraphs 5–16 of this paper and provide their reactions to:
 - (a) The new introductory material set out in paragraphs 600.1–600.2 of **Agenda Item C-5**;
 - (b) The enhanced general provisions set out in paragraphs 600.3 A–R600.11; and
 - (c) The ordering of the provisions in Section 600 and the subsections that follow.
2. Do Representatives agree with the new placement for the requirements and application material for management responsibilities (i.e., paragraphs R600.10–R600.11)?

⁶ Proposed Section 120, *The Conceptual Framework*

C. “Significance of the Threat” “Level of Threat” and Materiality

“Significance of the Threat” Versus “Level of Threat”

17. In the Explanatory Memorandum (EM) to Safeguards ED-1, the IESBA explained its view that the words “material,” “significant” or “significance,” the meaning of which is consistent with the concept of materiality as addressed in the International Standards on Auditing, are not appropriate for establishing the overarching requirements and principles about threats and safeguards. The EM also notes that the IESBA would consider whether further guidance is needed in the Code to better explain the meaning of those words in the context of providing NAS to audit clients.
18. At its June 2016 meeting, the IESBA agreed with the TF’s proposals to replace the words “...significance of the threat...” with the words “...level of the threat...” The IESBA also concluded that the words “significance” and “significant” should be used in a manner that is consistent with the concept of “materiality” in ISA 320⁷. Below is a discussion of the TF’s proposals for a new application material paragraph to explain materiality in relation to an audit client’s financial statements.
19. The TF believes that the phrase “... level of the threat...” aligns more closely with the term “acceptable level,” which is defined in the CF as “the level at which a professional accountant applying the reasonable and informed third party test would likely conclude that the professional accountant complies with the fundamental principles.

Implication of Proposal

20. Conforming amendments are needed throughout the Code to replace the words “...significance of the threat...” with “...level of the threat ...” Accordingly, the following phases in the extant Code will need to be updated in all instances:
 - (a) “...existence and significance of any threat will depend on factors such as...”
 - (b) “...significance of any threat shall be evaluated and safeguards applied...”

Materiality in Relation to an Audit Client’s Financial Statements

21. As noted above, the words “significant” or “significance” in the TF’s proposals are used in a manner that is consistent with the concept of materiality as discussed in ISA 320. Paragraph 600.3 A5 include new application material to explain how firms should consider materiality in relation to an audit client’s financial statements. This new application material draws on relevant information that was included in the 2012 [IESBA Staff Q&A, Implementing the Code of Ethics—Part II](#) and directs the firm to ISA 320. The new application material is relevant to the NAS section of the Code only, and explains that the determination of materiality:
 - (a) Involves the exercise of professional judgment and impacted by both quantitative and qualitative factors; and
 - (b) Is affected by perceptions of the financial information needs of users.

Matter for Future IESBA Consideration

22. The TF notes that the concept of materiality is applicable in other areas in the Code and not just in the

⁷ International Standard on Auditing (ISA) 320, *Materiality in Planning and Performing an Audit*

NAS section. For example, paragraph 510.3 notes that the “Section 510, *Financial Interests* refer to the “materiality” or “significance” of a financial interest. Section 510 states that “for the purposes of determining whether such an interest is material to an individual, the combined net worth of the individual and the individual’s immediate family members may be taken into account.”

23. The TF is of the view that a broader consideration of how the concept of materiality should apply in the context of the full Code, and not just NAS, might be needed. However, the TF believes that such an undertaking goes beyond the scope of the Safeguards project and would require coordination with the IAASB and the International Accounting Standards Board.

D. Other Specific Revisions by NAS Type

Subsection 602 – Administrative Services

24. The administrative services subsection was substantively revised as a result of the April 2015 NAS changes. Accordingly, as noted in paragraph 6(a) limited changes were made. As presented this subsection does not include requirements or application material. This is because the provision of administrative services involve assisting clients with routine and mechanical tasks within the normal course of operations, and generally do not create a threat.

Subsections 603, 604, 606 and 607 – Accounting and Bookkeeping Services, Including Preparing Accounting Records and Financial Statements, Valuation Services, Internal Audit Services, and Information Technology Systems (IT) Services

25. The TF notes that providing accounting and bookkeeping, valuation, internal audit, and IT services to an audit client might create self-review threats.⁸ Because the type of threat created by providing those services are the same, the TF agreed that the manner in which the threats are addressed, including the examples of actions that might be safeguards should also generally be the same.
26. The TF noted that some of the “examples of safeguards” in the extant Code were described differently when they essentially are the same. The TF’s proposals uses the same words to describe the “examples of safeguards” when they are the same.
27. The TF also agreed to retain the prohibitions related to providing:
- (a) Accounting and bookkeeping, valuation and IT services:⁹
 - (i) For audit clients that are not PIEs in paragraphs R603.7, R604.5 and R607.6.
 - (ii) For audit clients that are PIEs in paragraphs R603.8, R604.6 and R607.7.
 - (b) Internal audit services for audit clients that are PIEs in paragraph R606.6.¹⁰

Accounting and Bookkeeping Services, Including Preparing Accounting Records and Financial Statements

28. The TF observed that the title of the section heading in the extant Code “preparing accounting records and financial statements” did not align to the language in the first sentence in paragraph 290.165 of the extant Code, “Providing an audit client with accounting and bookkeeping services, such as preparing

⁸ See paragraphs 603.1, 604.2, 606.3 and 607.2 of **Agenda Item C-5**.

⁹ See paragraphs 290.169, 290.170, 290.176, 290.177, 290.200 and 290.203 of the extant Code.

¹⁰ See paragraph 290.177 of the extant Code.

accounting records and financial statements....”

29. At its June 2016 meeting, IESBA agreed with the TF’s suggestion to correct the title of Subsection 603 to be “Accounting and Bookkeeping Services, Including Preparing Accounting Records and Financial Statements”.

Subsection 605 – Taxation Services

30. The TF observed that the taxation services subsection is the longest in the NAS section of the Code. This is because the taxation services subsection includes additional requirements and application material for providing:
- (a) Tax return preparation;
 - (b) Tax calculations for the purposes of preparing accounting entries
 - (c) Tax planning and other tax advisory services; and
 - (d) Assistance in the resolution of tax disputes.
31. The TF continues to believe that providing taxation services to audit clients might create self-review or advocacy threats and has retained this statement from the extant Code. The requirements and application material, including the prohibitions pertaining to taxation services are retained, and the TF believes that the “examples of safeguards” are generally appropriate. However, the TF was of the view that the example of safeguard “obtaining advice on the service from a tax professional”¹¹ should not distinguish between professionals who are employed by the firm and those that external to the firm as long as the professional is not involved in the audit.
32. The refinements to taxation services subsection are primarily to restructure and to reflect conforming amendments arising from Safeguards ED-1. The TF also agreed to reorder the list of factors for evaluating the level of threats created by having a role in the resolution of tax disputes (see paragraph 605.12 A3). The TF is of the view that this revised order is more appropriate.

Subsection 608 – Litigation Support Services

33. The TF noted that there are no “examples of safeguards” in the litigation support services subsection of the extant Code. The TF continues to believe that this is appropriate.
34. Similar to the approach in the extant Code, paragraph 608.4 A1 refer firms and network firms to the requirements and application material for valuation services when providing litigation support serves that involve estimating damages or other amounts that affect the financial statements on which the firm will express an opinion. The TF has also developed new application material to explain that the audit client’s legal and regulatory environment in which the service is performed is a factor that is important to evaluating the level of any threat created by providing litigation support services (see paragraph 608.4 A2).

Acting as an Expert Witness

35. The TF is of the view that the nature of a litigation support service that includes acting as an expert witness vary significantly from one jurisdiction to another as a result of legal and regulatory requirements.

¹¹ See paragraph 605.6 A3, 605.9 A4, 605.12 A4 of **Agenda Item C-5** and paragraph 290.181, 290.186 and 290.189 of the extant Code.

As a result the TF does not believe that it is appropriate to include “examples of safeguards” to address the self-review or advocacy threats that might be created from acting as an expert witness on behalf of an audit client.

Subsections 609, 610 and 611 – Legal Services, Recruiting Services and Corporate Finance Services

36. The TF retained the requirements and application material, including the prohibitions, and “examples of safeguards” related to the provision of legal, recruiting and corporate finance services to audit clients.
37. The TF noted that the extant Code duplicated the “examples of the same safeguards” that might be applied to address threats created by providing legal and corporate finance services (see paragraphs 290.209 and 290.211 and paragraphs 290.213 and 290.214 respectively). The TF’s proposals do not include this duplication.

Prohibition for Providing Certain Recruiting Services to Audit Clients

38. Paragraph 290.210 of the extant Code prohibits firms and network firms from providing recruiting services to an audit client that is a PIE, in with respect to a director or officer of the entity or senior management 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.
39. At its June 2016 IESBA meeting, the IESBA agreed with the TF’s proposal to extend this prohibition more broadly to include audit clients that are not a PIEs (see paragraph R610.5).

Matter for CAG Consideration

3. Representatives are asked to consider the matters in Sections C and D of this paper and provide reactions to:
 - (a) The new application material pertaining to materiality in relation to an audit client’s financial statements (see paragraph 600.3 A5);
 - (b) The requirements and application material in each subsection (602–611).
4. Representatives are asked to comment on any other matters that are relevant to Phase 2 of the Safeguards project more broadly.

E. Matters that Go Beyond the Safeguards Project Scope

Safeguards in the NAS Section of the Code – Eliminating Duplication

43. The TF observed that many of the “examples of safeguards” in the NAS section are generally similar or the same irrespective of the type of NAS. An open issue for future consideration is whether those examples could be redrafted in a manner that avoids duplication. The TF plans to further explore this issue in conjunction with the Structure TF.

Consideration of the Role of TCWG

44. The Safeguards project proposal initially called for the TF to consider whether communicating with TCWG may be a safeguard. At its March 2016 meeting, IESBA concluded that auditor communication with TCWG, in itself, is not a safeguard, but rather could improve transparency and, in some cases, increase the effectiveness of safeguards.
45. The IESBA acknowledged that in some circumstances effective communications between the auditor and

TCWG may be useful in identifying, evaluating or addressing threats. Examples of those types of communications include:

- Informing TCWG of the NAS that is provided to an audit client;
 - Obtaining the concurrence of TCWG regarding the provision of a NAS to an audit client; or
 - Obtaining pre-approval from TCWG regarding the provision of a NAS to an audit client.
46. The IESBA noted that each option above, or a combination of all of the above options, might be appropriate, depending on the circumstances – auditors would need to apply professional judgment to determine which option would be appropriate. The IESBA also took the view that the nature and extent of auditor communication to TCWG is affected by the following factors:
- The size or nature of the NAS;
 - The expected duration of the NAS;
 - The size or nature of the NAS fee; and
 - Whether there are relevant laws and regulations pertaining to NAS that apply in the jurisdiction where the NAS would be provided to the audit client.
47. As noted above in earlier in this paper, the IESBA agreed to defer its discussions about enhancing auditor communication with TCWG.

Differential Requirements for PIEs and Non-PIEs

48. The EM to Safeguards ED-1 signaled that need to consider whether new application material should be developed to help firms and network firms understand the difference between requirements for PIEs and non-PIEs. This has been done as part of the TF's NAS work. However, some stakeholders have questioned whether the Code should continue to contain differential requirements with respect to PIEs and non-PIEs more broadly. The IESBA agreed with the TF that this matters goes beyond the scope of the Safeguards project and is a matter for future IESBA consideration.

Evolving Trends in Taxation Services

49. The TF is of the view that a more detailed review of certain provisions within the taxation services subsection is needed in light of evolving trends. The IESBA agreed with the TF that this matters goes beyond the scope of the Safeguards project and is a matter for future IESBA consideration.

Appendix 1
 (Para. 2)

Safeguards – Project Objectives and Progress To-date

This provides an overview of the specific matters set out in the Safeguards project proposal and a status of the TF's/IESBA's activities with respect to those matters.

	Project Objective Per Project Proposal	Current Status
1.	The description, definition and role of a safeguard within the CF approach of the Code	<ul style="list-style-type: none"> Addressed in Safeguards ED-1 in Sections 100 and 200 of extant Code Part C TF to consider conforming amendments as a result of Safeguards ED-1 Other conforming amendments to be developed, where applicable
2.	Examples of safeguards <ul style="list-style-type: none"> Environmental and threat/situation specific Mandatory or dependent on circumstances 	<ul style="list-style-type: none"> Addressed in Safeguards ED-1 Examples have been considered in the NAS section of the Code. Other conforming amendments to be developed, where applicable
3.	Process in assessing the relevance and effectiveness of a safeguard <ul style="list-style-type: none"> Identification and evaluation of a threat including impact of materiality and significance Direct correlation between a safeguard and the threat it is intended to address Effectiveness of safeguard Meaning of an “acceptable level” to which safeguards must reduce threats 	<ul style="list-style-type: none"> Addressed in Safeguards ED-1 Other conforming amendments to be developed, where applicable Specific to the point of “direct correlation between a safeguard and the threat it is intended to address” – this work is addressed in both Phases 1 and 2 of the Safeguards project
4.	Other considerations <ul style="list-style-type: none"> Other responses to reduce or eliminate threats Role of TCWG 	<ul style="list-style-type: none"> Addressed in Safeguards ED-1 (i.e. the requirement to address threats) With respect to consideration of the role of TCWG, during its March 2016 meeting the IESBA agreed to defer this matter for future consideration
5.	Consultations with stakeholders at various stages of the process such as: Regulators, National standard setters, Forum of Firms, and IFAC Small and Medium Practices (SMP) Committee	Ongoing
6.	Identification of proposed changes to the NAS section of the Code regarding responses to	See Agenda Item C-5

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	Project Objective Per Project Proposal	Current Status
	threats, facilitating compliance and enforceability	
7.	Make recommendations, if any, to the Board concerning broader scope of safeguards and other responses to threats, as appropriate, beyond NAS	See section E to this paper.