

Safeguards Phase 1 – Proposed Revisions to Safeguards ED-1

[Mark-up from IESBA June 2016 Discussion]

Note: IESBA Members are asked to note that the text shaded in gray has been developed by, and will be presented by, the Structure Task Force.

Part 1 – Complying with the Code, Fundamental Principles and Conceptual Framework

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Section 120

The Conceptual Framework

Introduction

- 120.1 The circumstances in which professional accountants operate might create threats to compliance with the fundamental principles. ~~The conceptual framework~~Section 120 sets out requirements and application material, including a conceptual framework, to assist the ~~professional~~ accountant in complying with the fundamental principles and meeting their responsibility to act in the public interest. It also accommodates the wide range of facts and circumstances, including the various professional activities, interests and relationships that create threats to compliance with the fundamental principles, ~~and~~. In addition it deters an accountant from concluding that a situation is permitted ~~if it solely because that situation~~ is not specifically prohibited by ~~this~~the Code.
- 120.2 The conceptual framework specifies an approach for the professional accountant to:
- (a) Identify threats to compliance with the fundamental principles;
 - (b) Evaluate the threats identified; and
 - (c) Address the threats by eliminating or reducing them to an acceptable level.

Requirements and Application Material

R120.3 The professional accountant shall apply the conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles set out in Section 1190.

120.3 A1 Additional requirements and application material that are relevant to the application of the conceptual framework are set out in:

- ~~Part 2B –~~Professional Accountants in Business;
- ~~Part 3C –~~ Professional Accountants in Public Practice; and
- ~~Part 4A and 4B C –~~ International Independence Standards as follows:

(i) Part 4A – includes the International Independence for Audits and Reviews; and

~~The Conceptual Framework contained in Section 120 applies in all circumstances~~

~~(+)(ii) Part 4B Standards – Independence for Other Assurance Engagements.~~

R120.4 When applying the conceptual framework, the professional accountant shall:

- (a) Exercise professional judgment;¹⁷
- (b) Remain alert for new information and to changes in facts and circumstances;¹⁷ and
- (c) Take into account the reasonable and informed third party ~~test concept~~ as described in paragraph 120.4 A1 below.

Reasonable and Informed Third Party ~~Test Concept~~

120.4 A1 The reasonable and informed third party test involves ~~a~~ consideration by the professional accountant about whether ~~an objective~~ the same conclusions would likely be reached by another person who possesses skills. Such person, a reasonable and informed third party, would possess sufficient knowledge and experience to objectively evaluate the appropriateness of the professional accountant's ~~judgments and conclusions would likely reach the same conclusions. This test entails that objective person weighing conclusions, and weigh~~ all the relevant facts and circumstances that the ~~professional~~ accountant knows, or could reasonably be expected to know, at the time ~~that the professional accountant's judgments and the~~ conclusions were made.

Identifying Threats

R120.5 The professional accountant shall identify threats to compliance with the fundamental principles.

120.5 A1 An understanding of the facts and circumstances, including professional activities, interests and relationships, that might compromise compliance with the fundamental principles is a prerequisite to the accountant's identification of threats to such compliance.

120.5 A2 Threats to compliance with the fundamental principles might be created by a broad range of facts and circumstances. It is not possible to define every situation that creates threats. In addition, the nature of engagements and work assignments might differ and, consequently, different types of threats might be created.

120.5 A3 Threats to compliance with the fundamental principles fall into one or more of the following categories:

- (a) Self-interest threat – the threat that a financial or other interest will inappropriately influence the professional accountant's judgment or behavior;
- (b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of ~~a~~
 - (i) A previous judgment made;¹⁸ or
 - (ii) An activity ~~or service~~ performed by the professional accountant, or by another individual within the accountant's firm or employing organization,

~~The Conceptual Framework contained in Section 120 applies in all circumstances~~

on which the accountant will rely when forming a judgment as part of performing a current activity or providing a current service;

- (c) Advocacy threat – the threat that a professional accountant will promote a client's or employer's position to the point that the accountant's objectivity is compromised;
- (d) Familiarity threat ~~—~~ the threat that due to a long or close relationship with a client, or employer, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
- (e) Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.

120.5 A4 A circumstance might create more than one threat, and a threat might affect compliance with more than one fundamental principle.

120.5 A5 Certain conditions, policies and procedures established by the profession, legislation, regulation, the firm or the employing organization might ~~act as a deterrent to unethical behavior, promote professional accountants acting ethically.~~ They ~~may~~might also ~~enhance~~facilitate the ~~professional~~ accountant's ~~ability to identify~~identification of threats. Examples of such conditions, policies and procedures include:

- Corporate governance requirements.
- Educational, training and experience requirements for the profession.
- Effective complaint systems which enable the professional accountant and the general public to draw attention to unethical behavior.
- An explicitly stated duty to report breaches of ethical requirements.
- Professional or regulatory monitoring and disciplinary procedures.

Evaluating Threats

R120.6 When the professional accountant identifies a threat to compliance with the fundamental principles, the ~~professional~~ accountant shall evaluate whether such a threat is at an acceptable level.

120.6 A1 The consideration of qualitative as well as quantitative factors is relevant to the professional accountant's evaluation of threats, as is the combined effect of multiple threats, if applicable.

120.6 A2 The existence of conditions, policies and procedures discussed in paragraph 120.5 A5 ~~above~~ might also impact the professional accountant's evaluation of the level of threats to compliance with the fundamental principles.

Acceptable Level

120.6 A3 An acceptable level is a level at which a professional accountant applying the reasonable and informed third party test would likely conclude that the ~~professional~~ accountant complies with

~~The Conceptual Framework contained in Section 120 applies in all circumstances~~

the fundamental principles.

Consideration of New Information or Changes in Facts and Circumstances

R120.7 If the professional accountant becomes aware of new information or changes in facts and circumstances that might impact whether a threat has been eliminated or reduced to an acceptable level, the accountant shall re-evaluate and address that threat accordingly.

120.7 A1 Remaining alert throughout the professional activity ~~or service~~ assists the professional accountant in determining whether new information has emerged or changes in facts and circumstances have occurred that:

- (a) Impact the level of a threat; or
- (b) Affect the ~~professional~~ accountant's conclusions about whether safeguards applied continue to be appropriate to address identified threats.

Addressing Threats

R120.8 If the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the ~~professional~~ accountant shall address the threats by eliminating or reducing them to an acceptable level. The ~~professional~~ accountant shall do so by:

- (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~~ ending the specific professional activity ~~or service involved~~.

Safeguards

120.8 A1 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.

120.8 A2 There are some situations in which the circumstances creating the threats cannot be eliminated and when there can be no safeguards to eliminate the threats created or reduce them to an acceptable level. In such situations, the professional accountant is required to decline or end the specific professional activity. ~~International Independence Standards in Parts C1 and C2 of the Code set out requirements and application material, including examples, of such situations.~~

Consideration of Significant Judgments Made and Overall Conclusions Reached

R120.9 The professional accountant shall form an overall conclusion about whether the actions that the profession accountant takes, or intends to take to address the threats created ~~in accordance with R120.8~~, will eliminate those threats or reduce them to an acceptable level. In forming the overall conclusion, the ~~professional~~ accountant shall:

- (a) Review any significant judgments made or conclusions reached.

~~The Conceptual Framework contained in Section 120 applies in all circumstances~~

- (b) Take into account the reasonable and informed third party test ~~as described in paragraph 120.4 A1.~~

Considerations for Audits, Reviews and Other Assurance Engagements

120.10A1 ~~The Code requires all professional accountants to comply with the fundamental principles. Professional accountants in public practice who perform are required to be independent when performing audits, reviews, or other assurance engagements. are also required to comply with International Independence Standards set out in C1 and C2.~~

~~R120.11 When performing engagements that require the professional accountant in public practice to be independent, the professional accountant in public practice shall apply the requirements and application material set out in the conceptual framework (see paragraphs 120.1–R120.9 above), to identify, evaluate and address threats to compliance with the International Independence Standards in C1 and C2.~~

120.11 A1 Independence is linked to the fundamental principles of objectivity and integrity. It 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 an audit ~~or assurance~~ team member's integrity, objectivity or professional skepticism has been compromised.

120.1041 A2 ~~Parts 4A and 4B of the Code comprise the International Independence Standards. These parts set out requirements and application material on how to apply the conceptual framework to maintain independence when performing audits, reviews or other assurance engagements, as the case may be. Professional accountants and firms are required to comply with these standards in order to be independent in relation to such engagements. The conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles applies in the same way to compliance with independence requirements. The categories of threats to compliance with the fundamental principles described in paragraph 120.5 A3 also apply to threats to compliance with independence. The categories of threats to compliance with the fundamental principles and to compliance with the International Independence Standards in C1 and C2 as described in paragraph 120.5 A3 are the same. Therefore, the conceptual framework to identify, evaluate and address those categories of threats applies to compliance with the fundamental principles as it does to compliance with independence standards.~~

~~The Conceptual Framework contained in Section 120 applies in all circumstances~~

PART 3 – PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

Section 300

Applying ~~the~~ ~~Conceptual Framework~~ – ~~Approach by~~ Professional Accountants in Public Practice

Introduction

300.1- This Part of the Code describes ~~considerations~~requirements and application material for professional accountants in public practice ~~to apply when applying~~ the conceptual framework set out in Section 120. It does not describe all of the facts and circumstances, including professional services, interests and relationships, that could be encountered by professional accountants[†] which create or might create threats to compliance with the fundamental principles. Therefore, professional accountants in public practice are required to be alert for such facts and circumstances.

300.2 The term “professional accountant” refers to professional accountants in public practice and their firms wherever it occurs in the remainder of *Professional Accountants in Public Practice*.

300.3 The requirements and application material that apply to professional accountants in public practice are set out as follows:

- *Part 3 – Professional Accountants in Public Practice*, Sections 300 to 399, applies to all professional accountants whether they provide assurance services or not.
- *Part 4A – Independence for Audits and Reviews*, Sections 400 to 899, applies to professional accountants in public practice when performing audit and review engagements.
- *Part 4B – Independence for Other Assurance Engagements*, Sections 900 to 999, applies to professional accountants in public practice when performing assurance engagements other than audit and review engagements.

~~{Placeholder for words to be developed by the Structure Task Force with input from the Safeguards Task Force to:~~

~~Explain the applicability of the provisions in Section 120, Section 400 [and Part B] to professional accountants in public practice; and~~

~~Indicate that threats to compliance with the fundamental principles in the case of assurance engagements should also be threats to independence.]~~

Requirements and Application Material

R300.34 A professional accountant shall comply with ~~each of~~ the fundamental principles set out in

[†] ~~Within Section 300, in Part C, the term “professional accountant” refers to professional accountants in public practice.~~

~~The Conceptual Framework contained in Section 120 applies in all circumstances~~

Section ~~400~~110 and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to compliance with ~~those~~the fundamental principles ~~or to reduce them to an acceptable level.~~

Identifying Threats

300.~~40~~45 A1 Compliance with the fundamental principles might be threatened by a broad range of facts and circumstances. The categories of threats are described in paragraph 120.5 A3. The following are examples of facts and circumstances within each of those categories of threats that might create threats for a professional accountant who is undertaking a professional activity:

(a) Self-interest Threats

- A professional accountant having a direct financial interest in a client.
- A professional accountant having undue dependence on total fees from a client or the possibility of losing a significant client.
- A professional accountant having a significant close business relationship with a client.
- ~~A member of the~~An audit team member entering into employment negotiation with the ~~audit~~ client.

(b) Self-review Threats

- A professional accountant issuing an assurance report on the effectiveness of the operation of financial systems after designing or implementing the systems.
- A professional accountant having prepared the original data used to generate records that are the subject matter of the assurance engagement.
- A professional accountant being, or having recently been, a director or officer of the client, or having recently been employed by the client in a position to exert significant influence over the subject matter of the engagement.
- ~~The~~A professional accountant performing a service for an assurance client that directly affects the subject matter information of the assurance engagement.

(c) Advocacy Threats

- ~~The~~A professional accountant promoting the interests of, or shares in, a client.
- A professional accountant acting as an advocate on behalf of an audit client in litigation or disputes with third parties.

(d) Familiarity Threats

- ~~A member of the~~An engagement team member having a close or immediate family member who is a director or officer of the client, or is an employee of the client and is in a position to exert significant influence over the subject matter of the engagement.

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- A director or officer of the client, or an employee in a position to exert significant influence over the subject matter of the engagement, having recently served as the engagement partner.
 - ~~Senior personnel~~Personnel having a long association with the assurance client.
- (e) Intimidation Threats
- A professional accountant being threatened with dismissal from a client engagement.
 - A professional accountant feeling pressured to agree with the judgment of a client employee because the employee has more expertise on the matter in question.
 - A professional accountant being informed by the firm that a planned promotion will not occur unless the ~~professional~~ accountant agrees with an audit client's inappropriate accounting treatment.

Evaluating Threats

- 300.~~56~~ A1 Conditions, policies and procedures established by the profession, legislation, regulation, the firm or the employing organization that might enhance the professional accountant's identification of threats and also impact the evaluation of whether a threat to compliance with the fundamental principles is at an acceptable level include the nature of:
- (a) The client and its operating environment;
 - (b) The professional ~~service~~activity being provided; and
 - (c) The firm and its operating environment.

The Client and its Operating Environment

- 300.~~56~~ A2 The professional accountant's evaluation of the level of a threat might be impacted by the following:
- (a) An audit client and whether the audit client is a public interest entity;
 - (b) An assurance client that is not an audit client; or
 - (c) A non-assurance client.

For example, providing a ~~non-assurance~~ service to an audit client, might be perceived to result in a higher level of threat to ~~compliance with~~ the fundamental principle of objectivity. Such a threat might be further increased when the audit client is a public interest entity.

- 300.~~56~~ A3 The corporate governance structure, including the leadership, of a client ~~can influence a professional accountant's~~might promote compliance with the fundamental principles. Accordingly, ~~a professional an~~ accountant's evaluation of the level of ~~the~~ threat might also be impacted by a client's operating environment. For example:

- The client requires appropriate persons other than management to ratify or approve the

~~The Conceptual Framework contained in Section 120 applies in all circumstances~~

appointment of a firm to perform an engagement.

- The client has competent employees with experience and seniority to make managerial decisions.
- The client has implemented internal procedures that facilitate objective choices in tendering non-assurance engagements.
- The client has a corporate governance structure that provides appropriate oversight and communications regarding the firm's services.

~~The Type of Professional Service Being ProvidedActivity~~

300.56 A4 The professional accountant's evaluation of the level of a threat is impacted by the nature and scope of the professional activity. ~~The International Independence Standards (Parts 4A and 4B) include a further discussion with examples of the threats that might arise when an accountant provides certain types of professional services, i.e., a non-assurance service to an audit client. service. Examples of professional services, the threats that might arise as a result, and how a professional accountant may address those threats are discussed in International Independence Standards C1 and C2~~

~~The Firm and its Operating Environment~~

300.56 A5 A professional accountant's evaluation of the level of a threat might be impacted by the work environment within a firm and its operating environment. For example:

- Leadership of the firm that promotes compliance with the fundamental principles and establishes the expectation that ~~members of the~~ assurance team members will act in the public interest.
- Conditions, policies or procedures for establishing and monitoring compliance with the fundamental principles by all personnel.
- Compensation, performance appraisal and disciplinary policies and procedures that promote compliance with the fundamental principles.
- Management of the reliance on revenue received from a single client.
- The engagement partner having authority within the firm for decisions concerning compliance with the fundamental principles, including decisions about accepting or providing non-assurance services to an audit client.
- Educational, training and experience requirements.
- Processes to facilitate and address internal and external concerns or complaints.

~~Consideration of New Information or Changes in Facts and Circumstances~~

300.56 A6 New information or changes in facts and circumstances might:

- (a) Impact the level of a threat; or

~~The Conceptual Framework contained in Section 120 applies in all circumstances~~

(b) Affect the professional accountant's conclusions about whether safeguards applied continue to be appropriate to address identified threats.

300.56 A7 Examples of new information or changes in facts and circumstances that might impact the level of a threat include:

- When the scope of a professional service is expanded.
- When the client becomes a listed entity or acquires another business unit.
- When the firm merges with another firm.
- Where ~~a member of the an~~ engagement ~~team's team member's~~ immediate family member is recently employed by the client.

In the situations described above, actions that were already implemented as safeguards might no longer be effective in addressing threats. Accordingly, the application of the conceptual framework requires that the professional accountant assess the need to re-evaluate and address any new threats and address them accordingly (see paragraph R120.8).

Addressing Threats

Examples of Safeguards

300.67 A1 ~~Paragraphs R120.8–Section 120.8 A2 includes sets out~~ requirements and application ~~material~~ for addressing threats. Safeguards vary depending on the facts and circumstances. Below are examples of actions that in certain circumstances might be safeguards in addressing threats:

- Having a professional accountant who was not involved with the non-assurance service provided to an audit client review the non-assurance work performed, or advise as necessary, might address a self-review threat.
- Having a professional accountant who was not a member of the team review the work performed or advise as necessary ~~may~~ address ~~a~~ self-review threats.
- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client ~~may~~ address self-review and familiarity threats.
- ~~Consulting or seeking approval from those charged with governance or an independent third party, including a committee of independent directors, a professional regulatory body or another professional accountant might address advocacy or intimidation threats.~~
- Involving another firm to perform or re-perform part of the engagement might address self-interest, self-review, advocacy or familiarity threats.
- Rotating assurance team personnel might address self-interest and familiarity threats.

~~Consideration of Significant Judgments Made and Overall Conclusions Reached~~

~~300.6 A2—The professional accountant shall form an overall conclusion about whether the actions that the profession accountant takes, or intends to take to address the threats created in~~

~~The Conceptual Framework contained in Section 120 applies in all circumstances~~

~~accordance with R120.8, will eliminate those threats or reduce them to an acceptable level. In forming the overall conclusion, the professional accountant shall:~~

~~(a) Review any significant judgments made or conclusions reached.~~

~~(b) Take into account the reasonable and informed third party test as described in paragraph 120.4 A1.~~