

Safeguards Phases 1 and 2—Issues and Task Force (TF) Proposals

How the Project Serves the Public Interest

This project addresses the clarity, appropriateness and effectiveness of safeguards in the extant Code. Phase 1 of the project includes revisions to safeguards in Section 100¹ and Section 200² of the extant Code.³ Phase 2 of the project deals with safeguards that pertain to non–assurance services (NAS) in Section 290⁴ and other conforming changes to the extant Code that are deemed necessary.⁵

Varying views exist about what constitutes a safeguard, as well as on the effectiveness and appropriateness of the examples of safeguards within the Code whether they are appropriate to eliminate threats to independence and compliance with the fundamental principles or reduce them to an acceptable level.

Enhanced requirements and application material about how to identify, evaluate and address threats to compliance with the fundamental principles and threats to independence (i.e., apply the conceptual framework (CF)), will support PAs (PAs) in fulfilling their responsibility to act in the public interest, and with respect to audits of financial statements, contribute to supporting audit quality.

Introduction

1. At its September 2016 meeting, the IESBA considered and broadly agreed the direction for a revised draft of the text of Phase 1 of its Safeguards project, comprising revisions to the provisions in the extant Code relating to the conceptual framework (restructured Section 120⁶) and the application of the conceptual framework to professional accountants (PAs) in public practice (restructured Section 300⁷). The Board deliberated about, and provided input on a number of specific provisions, including:
 - The description of the reasonable and informed third party;
 - The description of the term “safeguards;” and
 - The relationship between factors that are relevant to evaluating the level of a threats (i.e., conditions, policies and procedures established by the profession, legislation, regulation and the firm) and safeguards.

The IESBA also agreed on revisions to the various examples of safeguards in Section 300.

¹ Extant Section 100, *Introduction and Fundamental Principles* (Part A, General Application of the **Code**)

² Extant Section 200, *Introduction* (Part B – Professional Accountants in Public Practice)

³ Phase 1 of the Safeguards project includes proposed revisions to paragraphs 100.12–100.16 and paragraphs 200.3–200.15 of the extant Code.

⁴ Extant Section 290, *Independence – Audit and Review Engagements*

⁵ Phase 2 of the Safeguards project will explore proposals to enhance safeguards in:

- Paragraphs 290.100 to 290.101 of the extant Code, titled *Application of the Conceptual Framework Approach to Independence*.
- Paragraphs 290.154 to 290.216, *Provision of Non-Assurance Services to an Audit Client*.
- Other sections of the Code, including Section 291 (i.e., conforming amendments arising from the Safeguards project).

⁶ Section 120, *The Conceptual Framework* (Part 1, Complying with the Code, Fundamental Principles and the Conceptual Framework)

⁷ Section 300, *Applying the Conceptual Framework – Professional Accountants in Public Practice* (Part 3, Professional Accountants in Public Practice)

2. The IESBA agreed to consider a revised draft of the Safeguards Phase 1 text during its December 2016 meeting, with a view to reaching agreement in principle, pending finalization of Phase 2 of the project.
3. With respect to Phase 2, at its September 2016 meeting, the IESBA considered a second-read draft of revisions to proposed Section 600.⁸ The Board also provided input on the TF's proposals for conforming amendments arising from the Safeguards project to other areas of the Code, including to the Structure Phase 1 and 2 text.
4. The purpose of this paper is to summarize the significant revisions to the TF's proposals since the September 2016 IESBA meeting drafts. The paper is organized as follows:
 - (a) Revisions to Safeguards Phase 1 Since September 2016 IESBA Meeting (Section 120 and 300⁹);
 - (b) Issues relating NAS (Proposed Sections 600 and 950);¹⁰ and
 - (c) Issues relating to proposed conforming amendments arising from the Safeguards project.

Issues and TF Proposals

A. Revisions to Safeguards Phase 1 Text Since September 2016 IESBA Meeting

Safeguards Verses Factors That Impact the Identification and Evaluation of the Level of Threats

5. The TF affirmed its view that the requirements and application material in Section 120 are sufficient and appropriate to explain that certain conditions, policies and procedures established by the professional, legislation, regulation, the firm, or the employing organization that can enhance the PA acting ethically might also impact the identification and evaluation of threats to compliance with the fundamental principles (paragraphs 120.6 A1 and 120.7 A2).
6. In direct contrast to extant Code, the new application material clarifies that those conditions, policies and procedures are no longer characterized as safeguards because they do not meet the new description of safeguards set out in paragraph 120.10 A1. Examples of those conditions, policies and procedures include:
 - Corporate governance requirements.
 - Educational, training and experience requirements for the profession.
 - Effective complaint systems which enable the PA and the general public to draw attention to unethical behavior.
 - An explicitly stated duty to report breaches of ethics requirements.
 - Professional or regulatory monitoring and disciplinary procedures

Accordingly, as further discussed in Section C of this paper, throughout the Code the TF has proposed conforming amendments to explain that examples of conditions, policies and procedures are factors relevant to evaluating the level of a threat.

⁸ Section 600, *Provision of Non-assurance Services to an Audit Client*

⁹ Section 300, *Applying the Conceptual Framework – Professional Accountants in Public Practice*

¹⁰ Section 950, *Provision of Non-assurance Services to an Assurance Client*

7. Within Section 300, the TF has clarified that those conditions, policies and procedures might relate to the client and its operating environment as well as the firm and its operating environment. Revisions have been made in paragraph 300.7 A1 to clarify that the PA's evaluation of the level of the threat is also impacted by the nature and scope of the professional service. Consequently, paragraph 300.6 A4 of the September 2016 draft is dropped.

Section 120

8. Section 120 includes the conceptual framework, a simple three step-approach for PAs to identify, evaluate and address threats to compliance with the fundamental principles and to independence. The conceptual framework set out in Section 120 is applicable to all PAs. In addition to the editorial refinements in **Agenda Item 4-B**, responsive to suggestions made by some IESBA members, the TF has:
 - Replaced the words “in an objective manner” with “impartiality” in paragraph 120.5 A3. This change was suggested by an IESBA member and IESBA members generally agreed that the use of the word impartiality was clearer.
 - Dropped the bullet in paragraph 120.7 A2 that reads “external review by a legally empowered third party of the reports, returns, communications or information produced by a PA.” The deleted text, which was included in the extant Code, was not included in Safeguards ED-1, but was added to the proposed text as an example of a condition established by regulation or an audit oversight authority that might impact the evaluation of the level of threats. However, the TF agrees with the Board that the example is unclear and has dropped it.
 - Changed the phrase “applying the reasonable and informed third party...” to “using the reasonable and informed third party” in order to be consistent with the word “use” in paragraph R120.5 (d).
 - Clarified the description of safeguards in 120.10 A1 to explain that safeguards are actions that effectively reduce threat to compliance with the fundamental principles to an acceptable level. The revised application material now makes it clearer that safeguards cannot eliminate threats, but rather only reduce them to an acceptable level.

Section 300

9. Some IESBA members suggested that the TF review the examples of each set of facts and circumstances with each category of threats 300.6 A1 in order to be sure that each of the fundamental principles are covered. As a result of this review, the TF has revised some of the examples in paragraph 300.6 A1 of **Agenda Item 4-B**. Similarly, the TF has refined the examples of safeguards in paragraph 300.8 A1 to take into account suggestions made by some IESBA members.
10. To enhance the clarity of the section titled, Consideration of New Information or Changes in Facts and Circumstances, the TF has repositioned the last two sentences in 300.7 A7 to be the last sentences 300.7 A6.

Placeholders for Proposals Being Developed by Others

11. The Task Force notes work that is currently being progressed by the Part C Task Force and the IESBA Professional Skepticism Working Group and has included placeholders in **Agenda Item 4-B** for their respective proposals.

Matters for IESBA Consideration

1. IESBA members are asked whether they agree with the revisions in **Agenda Item 4-B**.
2. Do IESBA members agree that the revisions made since Safeguards ED-1 set out in **Agenda Item 4-C** address the significant matters raised by respondents?

B. Issues Relating to NAS (Proposed Sections 600 and 950)

Section 600

12. The TF's NAS proposals build on what is already a more robust set of NAS requirements and application material with the April 2015 NAS release and Phases 1 of the Safeguards and Structure projects.¹¹
13. The IESBA discussed and generally agreed to the placement of requirements that prohibit providing certain types of non-assurance services (NAS) to audit clients. The Board agreed to the following order:
 - (a) First, general application material that support that the overarching requirements in the conceptual framework set out in Section 120.
 - (b) Second, requirements and application material for audit clients that are not public interest entities (PIEs).
 - (c) Third, requirements and application material for audit clients that are PIEs.

This conclusion has implications for all the subsections in Section 600. Accordingly, the TF's revised proposals set out in **Agenda Item 4-D** include revisions for this new ordering.

14. The Board also agreed for Section 600 to:
 - More prominently feature the requirements and application material for avoiding the assumption of management responsibilities.
 - Include more robust general provisions to assist PAs 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.
 - Include a clear and explicit statement that, in certain situations, the Code prohibits firms and network firms from providing certain NAS to an audit client because there can be no safeguards to address the threats to independence.
 - Incorporate revisions to conform to the new overarching requirement in the conceptual framework (i.e., paragraph R120.10) for addressing threats. Thus, the proposed text provides examples of actions that might be safeguards to address the specific threat created by providing the specific type

¹¹ In April 2016, the IESBA's Release, [Changes to the Code Addressing Certain Non-Assurance Services Provisions for Audit and Assurance Clients](#), became effective. 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.

of NAS. This approach is intended to emphasize the other actions that might, depending on the facts and circumstances, be more appropriate to address the specific threat.¹²

- Further emphasize the need for firms and network firms to comply with the fundamental principles, in addition to independence requirements, when providing NAS to audit clients.
- Include new application material to explain the concept of materiality in relation to an audit client's financial statements.
- Include new application material to remind firms and network firms to consider the combined effect of threats created from providing multiple NAS to the same audit client.

Introduction and General

15. The TF agreed to the revisions in the introduction section (i.e., paragraphs 600.1–600.3) in close coordination with the Structure TF. These revisions are to achieve consistency with the other Sections of the restructured Code and are not intended to change the meaning of the September 2016 draft.

Requirements and Application Material – General

16. Some IESBA members questioned the TF's rationale for the use of "accepts or provides NAS" in paragraph 600.4 A1. In response, the TF has dropped the words "accepts or" in paragraph 600.4 A1, and reinstated the requirement for firms to determine whether providing a NAS to an audit client would create a threat to independence before accepting the NAS engagement (see paragraph R600.4).¹³
17. The TF has agreed with many of the editorial suggestions that IESBA members provided to refine and clarify the general section of Section 600. For example, the TF's has simplified the requirement relating to the considerations for certain related entities in paragraph R600.10.
18. The general section also include suggested revisions from Structure TF, that are intended to assist PAs better navigate and understand the NAS section of the Code. For example, paragraph 600.4 sets out factors that are relevant in evaluating the level of a threat. The last sentence of that paragraph indicates that the subsections include more specific factors that are relevant to evaluating the level of any threats created by providing certain NAS to audit clients.

Requirements and Application Material – Subsections

19. The TF has retained the requirements and application material relating to avoiding management responsibilities when providing NAS in the general section. Accordingly, the TF has revised the ordering, titles and layout of each of the subsections. In this regard, further editorial refinements were made to the subsections, taking into account many of the suggestions made by some IESBA members. As a result, the TF determined it necessary to drop certain duplicate application material, for example, in subsection 601.
20. In close coordination with the Structure TF, the TF agreed to revisions to the introduction of all the

¹² Other actions that might address threats as set out in paragraph R120.10 are to:

- (a) Eliminate the circumstance, including interests or relationships, that is creating the threat(s); or
- (b) Decline or end the specific professional activity.

¹³ See 290.156 of the extant Code.

subsections to achieve consistency and to explain the interaction to the conceptual framework. The introduction to each NAS subsection states that “The requirements and application material set out in Section 600 are relevant to this subsection.” In subsections that include requirements that prohibit the provision of certain NAS in certain circumstances (i.e., 601, 603, 604, 605, 606, 608, 609 and 610), revisions have been made to the introduction to clarify that in some circumstances, the specific NAS is expressly prohibited because the threats cannot be eliminated, or there can be no safeguards to reduce the threat to an acceptable level. Where applicable, the other substantive revisions made to each of the NAS subsections since the September 2016 draft are provided below.

- (a) Subsection 601, Accounting and Bookkeeping Services – The TF has developed new application material in 601.3 A1 to describe the nature of accounting and bookkeeping services. Doing so supports the TF’s decision to streamline the title of the subsection in accordance to the Structure Drafting Guidelines.
- (b) Subsection 602, Administrative Services – Some IESBA members questioned the need for a stand-alone administrative services subsection, and suggested that it be subsumed into another subsection. The TF considered the suggestion and concluded that having a stand-alone subsection for administrative services makes the Code clearer because administrative services is a type of a NAS that is provided by firms and network firms. The TF notes that in some circumstances, firms and network firms might provide administrative services in conjunction with other types of NAS. In such circumstances, the TF believes that the enhanced general requirements in Section 600 and the respective NAS subsections would also apply. The TF also notes that the suggestion for having a stand-alone administrative services subsection was debated and rejected by the Board when the NAS section of the extant Code was revised and approved in April 2015.
- (c) Subsection 603, Valuation Services – No other substantive revisions.
- (d) Subsection 604, Taxation Services – The taxation services subsection explains that the taxation services comprise a broad ranges of services, including tax return preparation, tax calculation for the purpose of preparing the accounting entries, tax planning and other tax advisory services, and assistance in the resolution of tax disputes. Paragraph 604.4 A2 includes a list of factors that are relevant in evaluating the level of threats created by providing any taxation services. The subsection also includes additional factors that are relevant in evaluating the level of threats created by providing some of the specific types of tax services (i.e. paragraphs 604.7 A2, 604.10 A1, 604.12 A3 and 606.16 A1). For clarity, the TF’s revised proposals explain that those specific factors are relevant in addition to those in paragraph 604.4 A2.
- (e) Subsection 605, Internal Audit Services – To enhance readability, a new subheading titled “Using the Work of an Internal Audit Function in an Audit Engagement” precedes paragraph 605.7 A1. The TF believes that this subheading is helpful to distinguish the application material from other material in the subsection that is relevant when providing internal audit services as a NAS to an audit client.
- (f) Subsection 606, Information Technology (IT) Systems Services – Drawing from the extant Code, the TF has expanded on its initial proposals to develop new application material in paragraph 606.5 A1 with factors that are relevant in evaluating the level of threats created by providing IT systems services to an audit client.
- (g) Subsection 607, Litigation Support Services – Taking into account suggestions from some IESBA members, the TF has revised the application material with factors that are relevant in evaluating the

level of threat created by providing litigation support services to an audit client (see paragraph 607.4 A1).

- (h) Subsection 608, Legal Services – Several revisions have been made to the TF’s initial proposals to better explain the specific types of legal services (i.e., legal advisory services, acting as general counsel, and legal services involving acting in an advocacy role) and provide examples of each of those types of services. The revisions also clarify the specific factors that are relevant in evaluating the level of threats associated with providing legal advisory services and legal services involving acting in an advocacy role, as well as the actions that might be safeguards to address those threats.
- (i) Subsection 609, Recruiting Services – No other substantive revisions.
- (j) Subsection 610, Corporate Finance Services – No other substantive revisions.

Section 950

- 21. **Agenda Item 4-E** includes the TF’s proposals for the Section 950, which is a revision of Section 291.138-291.148 of the extant Code, provision of NAS to an assurance client. The TF developed its proposals by extending its conclusion regarding providing a NAS to an audit client in Section 600 to providing a NAS to an assurance client in Section 950. The mapping table in **Agenda Item 4-F** is a comparison of the extant requirements and application material to the TF’s proposals.
- 22. Consistent with Section 600, the significant revisions to Section 950 include:
 - Clarification about the applicability of the conceptual framework and the need for firms to comply with the fundamental principles, in addition to independence requirements, when providing NAS to assurance clients. The overarching requirements and application material in the conceptual framework set out in the Section 120 are not repeated.
 - New general provisions to assist PAs identify, evaluate and address threats created by accepting and providing NAS to assurance clients, in particular when a NAS is not explicitly referenced in the Code.
 - More prominent requirements and application material for avoiding the assumption of management responsibilities.
 - New application material to explain the concept of materiality in relation to an assurance Client’s Information.
 - New application material to remind firms to consider the combined effect of threats created from providing multiple NAS to the same assurance client.

Matters for IESBA Consideration

- 3. IESBA members are asked to consider the matters in Section B of this paper, the TF’s proposals in **Agenda Item 4-D and 4-E**, and agree to the proposed text for:
 - (a) Section 600, *Provision of Non-assurance Services to An Audit Client*, and
 - (b) Section 950, *Provision of Non-assurance Services to An Assurance Client*.

C. Issues Relating to Proposed Conforming Amendments Arising from the Safeguards Project

23. The conforming amendments arising from the Safeguards project not expressly relating to the NAS section of the Code are shaded gray and are presented in:

- **Agenda Item 3-B**, Structure Phase 1 proposed text.
- **Agenda Item 5-B**, restructured text for Part C Phase 1 close-off document.
- **Agenda Item 8-B**, restructured text for the revised Long Association provisions.
- **Agenda Item 3-D**, Section 800 and Part 4B.

There were no conforming amendments arising from the Safeguards project to the restructured NOCLAR text.

24. At its September 2016 meeting, the Board generally agreed that conforming amendments are needed throughout the Code as a result of the revisions established in Safeguards Phase 1. In summary, those conforming amendments are to:

- (a) Drop duplicate requirements and application material that are already covered in the conceptual framework set out in Section 120. The introduction for each section of the restructured Code clarifies that the requirements and application material in the conceptual framework are also applicable.
- (b) Replace the words "...significance of the threat..." with "...level of the threat...". Accordingly, the words "significance" and "significant" are no longer used to describe threats. Paragraph 120.8 A1 defines acceptable level as a level at which a PA using the reasonable and informed third party test would conclude that the accountant complies with the fundamental principles. The TF believes that the restructured Code should avoid the phrase "higher level of threat" because it is subjective and does not have commonly understood meaning, and therefore is not as clear.
- (c) Change the extant Code examples of safeguards that are established by professional, legislation, regulation, the firm, or the employing organization to factors that are relevant in evaluating the level of threats. As explained at paragraph 5 to this paper those examples of safeguards in the extant Code are withdrawn and characterized as certain conditions, policies and procedures established by the professional, legislation, regulation, the firm, or the employing organization that might impact the PA's evaluation of the level of threats.
- (d) Clarify the various types of actions that can be taken to address threats in accordance to the new requirement to address threats established as part of Safeguards Phase 1 paragraph R120.10. Matters that were characterized as examples of safeguards in the extant Code are now classified as:
 - (i) Examples of actions that might be safeguards to address a specific threats;
 - (ii) Other actions that might address the threat i.e., the actions that the PA takes to:
 - a. Eliminate the circumstances, including the interests or relationships that are creating the threat); or
 - b. Decline or end the specific professional activity.

Breaches Verses Threats to the Fundamental Principles

25. The TF observed that the term “breach the fundamental principles” is used differently in the extant Code. For example, in the Independence sections of the Code, the term “breaches” is used to refer to a circumstances when the PA has not complied with a specific fundamental principle. However, in Section 270, the term is used as a short-hand to threats to compliance with the fundamental principles. To avoid confusion, as part of its conforming amendments, the TF has agreed to use the word breaches in the restructured Code only to refer to a circumstance when the PA has not complied with the fundamental principles. By way of an example, the implication of this conclusion is seen in the TF’s revisions to paragraphs 270.4 A2 and 270.4 A3–R270.5 in **Agenda Item 5-B**.

Conforming Amendments to the Section of the Code Relating to PAs in Business (PAIBs)

26. Some IESBA members questioned the extent of conforming amendments that were made to the PAIB section of the Code, in particular to Section 220¹⁴ and Section 270.¹⁵ Specifically, some IESBA members continue to question whether the requirements and application material in the conceptual framework should apply in a different way to PAIBs. The TF, together with the Structure and Part C TF confirm that the conceptual framework set out in Section 120 applies in the same way to PAIBs as it does to all other PAs. This is explained in the introduction section of Part 2 (i.e., paragraphs 200.1 – 200.4 of **Agenda Item 5-B**).
27. Similar to the approach taken in the general sections for the independence standards in Section 400 and 900, Section 200¹⁶ emphasizes and in some cases repeats certain material in Sections 120 and 300 that the Structure, Part C and Safeguards TF believe is helpful for PAIBs identifying, evaluating and address threats (for example, see paragraph 200.6 A1, 200.6 A2–200.7 A2).

Pressure to Breach the Fundamental Principles

28. With respect to Section 270, paragraph 270.4 A3 lists the factors that are relevant to evaluating the level of threats created by pressure. Paragraphs 270.4 A4 and 270.4 A5 now clarify that certain matters might assist PAIBs understand those factors. The TF has revised paragraph R270.5 that deals with addressing threats created by pressure, so that it is more aligned with R120.10. The revised paragraph indicates that threats created by pressure can be addressed by:
- (a) Eliminating the circumstances, interests or relationships, that are creating the threats; including resigning from the employing organization;
 - (b) Applying safeguards, where available or capable of being applied; or
 - (c) Declining or ending the specific professional activity.
29. Similarly to the extant [Part C Phase 1 close-off document](#), Section 270 does not include examples of safeguards. However, it includes an example of an action that might address threats by eliminating the circumstance creating the pressure (see paragraph 270.4 A6).

¹⁴ Section 220, *Preparation and Presentation of Information*

¹⁵ Section 270, *Pressure to Breach the Fundamental Principles*

¹⁶ Section 200, *Applying the Conceptual Framework – Professional Accountants in Business*

Matters for IESBA Consideration

4. IESBA members are asked to consider the matters in Section C of this paper, the TF's proposed conforming amendments (i.e., the text shaded in gray in **Agenda Items 3-B, 3-D, 5-B, and 8-B**), and agree to the proposed conforming amendments that are necessary as a result of the Safeguards project.
5. IESBA members are asked to comment on any other matters that are relevant to Phase 2 of the Safeguards project more broadly.