

Agenda Item 4-B

Safeguards Phase 1 – Proposed Text [Mark-up From Sept 30, 2016 IESBA Discussion]

Note to IESBA Meeting Participants: At its September 2016 meeting, the IESBA considered and broadly agreed to revisions to a draft of the text of Phase 1 of its Safeguards project. Those revisions are set out below.

Part 1 – Complying with the Code, Fundamental Principles and the 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. Section 120 sets out requirements and application material, including a conceptual framework, to assist accountants in complying with the fundamental principles and meeting their responsibility to act in the public interest. Such requirements and application material 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. In addition, they it-deters an accountant from concluding that a situation is permitted solely because that situation is not specifically prohibited by the Code.

Commented [DJ1]: 100.6

120.2 The conceptual framework specifies an approach for the professional accountant to:

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- (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 110.

Commented [DJ3]: New requirement

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

Commented [DJ4]: 100.3

- (a) Part 2 – *Professional Accountants in Business*;
- (b) Part 3 – *Professional Accountants in Public Practice*; and
- (c) ~~Part 4~~ – *International Independence Standards* as follows:
 - (i) Part 4A – *Independence for Audits and Reviews*; and
 - (ii) Part 4B – *Independence for Other Assurance Engagements*.

R120.4 Reserved for proposed requirement relating to the applicability of PAIB provisions to PAs in public practice (**See Agenda Item 5**).

120.4 A1 Reserved.

R120.54 When applying the conceptual framework, the professional accountant shall:

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(a) Reserved for proposal being developed by the IEBSA Professional Skepticism Working Group (see **Agenda Item 2**).

(a)(b) Exercise professional judgment;

(b)(c) Remain alert for new information and to changes in facts and circumstances; and

(c)(d) Use the reasonable and informed third party test as described in paragraph 120.54_A1.

120.5 A1 Reserved.

120.5 A2 Reserved.

Reasonable and Informed Third Party

120.54_A34 The reasonable and informed third party test is a consideration by the professional accountant about whether the same conclusions would likely be reached by another party. Such consideration is made from the perspective of a reasonable and informed third party, who weighing all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time the conclusions are made. The reasonable and informed third party does not need to be an accountant, but would possess the relevant knowledge and experience, and impartiality, to understand and evaluate the appropriateness of the accountant's conclusions in an objective manner.

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Identifying Threats

R120.65 The professional accountant shall identify threats to compliance with the fundamental principles.

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120.65 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 professional accountant's identification of threats to such compliance. Certain conditions, policies and procedures established by the profession, legislation, regulation, the firm, or the employing organization that can enhance the professional accountant acting ethically, might also impact the identification of threats to compliance with the fundamental principles.

Commented [DJ8]: 100.8, 100.16

120.65_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.

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120.6_5-A3 Threats to compliance with the fundamental principles fall into one or more of the following categories:

Commented [DJ10]: 100.6, 100.12

- (a) Self-interest threat – the threat that a financial or other interest will inappropriately influence a professional accountant’s judgment or behavior;
- (b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made; or an activity performed by the professional accountant, or by another individual within the accountant’s firm or employing organization, on which the accountant will rely when forming a judgment as part of performing a current activity;
- (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.

120.65_A4 A circumstance might create more than one threat, and a threat might affect compliance with more than one fundamental principle.

Commented [DJ11]: New application material

Evaluating Threats

R120.76 When the professional accountant identifies a threat to compliance with the fundamental principles, the accountant shall evaluate whether such a threat is at an acceptable level.

120.76_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.

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120.76_A2 The existence of conditions, policies and procedures discussed described in paragraph 120.65 A1 might also facilitate impact the accountant’s evaluation of the level of threats to compliance with the fundamental principles. Examples of such conditions, policies and procedures include:

Commented [DJ13]: 100.13, 100.14, 100.16

- 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 ethics requirements.
- Professional or regulatory monitoring and disciplinary procedures.
- ~~External review by a legally empowered third party of the reports, returns, communications or information produced by a professional accountant.~~

Acceptable Level

120.86_A13 An acceptable level is a level at which a professional accountant applying using the reasonable and informed third party test would likely conclude that the accountant complies with the fundamental principles.

Commented [DJ14]: Glossary

Consideration of New Information or Changes in Facts and Circumstances

R120.97 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.

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120.97_A1 Remaining alert throughout the professional activity assists the professional accountant in determining whether new information has emerged or changes in facts and circumstances have occurred that:

Commented [DJ16]: New application material

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

Addressing Threats

R120.108 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 them or reducing them to an acceptable level. The accountant shall do so by:

Commented [DJ17]: New requirement

- (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 ending the specific professional activity.

Safeguards

120.108_A1 Safeguards are actions, individually or in combination, that the professional accountant takes that effectively ~~eliminate~~reduce threats to compliance with the fundamental principles or ~~reduce them~~ to an acceptable level. However, there are some situations in which threats can only be addressed by declining or ending the specific professional activity. This is because the circumstances that created the threats cannot be eliminated or safeguards are not capable of being applied to reduceing the level of the threat to an acceptable level.

Commented [DJ18]: 100.9, 100.13

Consideration of Significant Judgments Made and Overall Conclusions Reached

R120.119 The professional accountant shall form an overall conclusion about whether the actions that the accountant takes, or intends to take, to address the threats created will eliminate those threats or reduce them to an acceptable level. In forming the overall conclusion, the accountant shall:

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- (a) Review any significant judgments made or conclusions reached; and.
- (b) Use the reasonable and informed third party test.

Considerations for Audits, Reviews and Other Assurance Engagements

120.120 A1 Professional accountants in public practice are required to be independent when performing audits, reviews, or other assurance engagements. 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 that a firm's or an audit or assurance team member's integrity, objectivity or professional skepticism has been compromised.

Commented [DJ20]: New sentences

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120.120 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 when conducting 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 120.65–A3 are also the categories of threats to compliance with independence.

Commented [DJ22]: New application material

120.13 A1 Reserved for proposal being developed by the IEBSA Professional Skepticism Working Group (see **Agenda Item 2**).

120.13 A2 Reserved

120.13 A3 Reserved

PART 3 – PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

Section 300

Applying the Conceptual Framework – Professional Accountants in Public Practice

Introduction

300.1 This Part of the Code describes requirements and application material for professional accountants in public practice when applying the conceptual framework set out in Section 120. It does not describe all of the facts and circumstances, including professional activities, interests and relationships, that could be encountered by professional accountants in public practice, 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.

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

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- Part 3 – *Professional Accountants in Public Practice*, Sections 300 to 399, applies to all professional accountants, whether they provide assurance services or not.
- ~~Part 4—~~*International Independence Standards* as follows:
 - (i) Part 4A – *Independence for Audits and Reviews*, Sections 400 to 899, applies to professional accountants in public practice when performing audit and review engagements.
 - (ii) 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.

300.3 In this Part, the term “professional accountant” refers to professional accountants in public practice and their firms, wherever it occurs in the remainder of Part 3

Commented [DJ25]: Footnote to 200.1

Requirements and Application Material

R300.4 A professional accountant shall comply with the fundamental principles set out in Section 110 and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to compliance with the fundamental principles.

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R300.5 Reserved for requirement relating to the applicability of PAIB provisions to PAs in public practice (See **Agenda Item 5**).

300.5 A1 Reserved.

Identifying Threats

300.56 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 120.65-A3. The following

Commented [DJ27]: 200.1, 200.2, 200.4, 200.6, 200.7, 200.8

are examples of facts and circumstances within each of those categories of threats that might create threats for a professional accountant ~~who is~~when undertaking a professional service:

(a) Self-interest Threats

- A professional accountant having a direct financial interest in a client.
- A professional accountant quoting a low fee to obtain a new engagement and the fee is so low that it may~~might~~ be difficult to perform the professional service in accordance with applicable technical and professional standards for that price.
- A professional accountant having a close business relationship~~joint venture~~ with a client.
- ~~A professional accountant accepting~~providing a professional service before knowing all the pertinent facts necessary to determine whether the professional accountant has the skills, knowledge and experience to perform the engagement.
- A professional accountant having access to confidential information that might be used for personal gain.

(b) Self-review Threats

- A professional accountant issuing an assurance report on the effectiveness of the operation of financial systems after implementing the systems.
- ~~A professional accountant being asked to assess and comment on processes that were designed by the accountant.~~
- A professional accountant having prepared the original data used to generate records that are the subject matter of the assurance engagement.
- A professional accountant discovering a significant error when evaluating the results of a previous professional service performed by a member of the accountant's firm.

(c) Advocacy Threats

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

(d) Familiarity Threats

- A professional accountant having a close or immediate family member who is a director or officer of the client.
- 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.
- An audit team member having a long association with the audit client.

(e) Intimidation Threats

- A professional accountant being threatened with dismissal from a client engagement or the employing organization because of a disagreement about a professional matter.
- 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 accountant agrees with an ~~audit client's~~ inappropriate accounting treatment.
- ~~A professional accountant having accepted a significant gift from a client and being threatened that such~~ acceptance of this gift offer will be made public.

Evaluating Threats

300.6-7_A1 Conditions, policies and procedures as described in 120.65 A1 might impact the evaluation of whether a threat to compliance with the fundamental principles is at an acceptable level. Such conditions, policies and procedures might relate to:

Commented [DJ28]: 200.3, 200.12

- (a) The client and its operating environment; and
- ~~(b) The professional service being provided; and~~
- (b) The firm and its operating environment.

The professional accountant's evaluation of the level of a threat is also impacted by the nature and scope of the professional service.

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The Client and its Operating Environment

300.6-7_A2 The professional accountant's evaluation of the level of a threat might be impacted by whether the client is:

- (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 that is a public interest entity, might be perceived to result in a higher level of threat to compliance with the ~~fundamental~~ principle of objectivity with respect to the audit.

300.6-7_A3 The corporate governance structure, including the leadership, of a client might promote compliance with the fundamental principles. Accordingly, a professional accountant's evaluation of the level of a threat might also be impacted by a client's operating environment. For example:

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

300.6-A4 ~~The professional accountant's evaluation of the level of a threat is impacted by the nature and scope of the professional service. In addition, the *International Independence Standards* (Parts 4A and 4B) include a further discussion with examples of the threats that might arise when a professional accountant provides certain types of professional services, i.e., a non-assurance service, to an audit or assurance client.~~

The Firm and its Operating Environment

300.6-Z 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:

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- Leadership of the firm that promotes compliance with the fundamental principles and establishes the expectation that assurance team members will act in the public interest.
- 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 services to a 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

300.6-Z A6 New information or changes in facts and circumstances might:

Commented [DJ32]: New application material

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

In these situations, 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 re-evaluate and address the threats accordingly (see paragraphs R120.9 and R120.10).

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

Commented [DJ33]: New application material

- 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.
- When the professional accountant is jointly engaged by two clients and ~~a situation evolves in a dispute~~ emerges between the two clients.

~~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 re-evaluate and address the threats accordingly (see paragraphs R120.7 and R120.8).~~

Addressing Threats

Examples of Safeguards

300.7-8_A1 ~~Section 120 sets out requirements and application material for addressing threats. Safeguards vary depending on the facts and circumstances. Examples of actions that in certain circumstances might be safeguards in to addressing threats include:~~

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- ~~Assigning appropriate additional time and qualified staff personnel to the required tasks when an engagement has been accepted~~ might address a self-interest threat.
- Having a professional accountant who was not a member of the team review the work performed or advise as necessary might address self-review threats.
- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client might address self-review and familiarity threats.
- Involving another firm to perform or re-perform part of the engagement might address self-interest, self-review, advocacy or familiarity threats.
- ~~Disclosing to intended users of the work performed by the professional accountant and the basis of remuneration clients any referral fees or commission arrangements received for recommending services or products~~ might address self-interest and advocacy threats.
- Separation of teams when dealing with matters of a confidential nature might address self-interest threats.