

April 25, 2017

IFAC Small and Medium Practices (SMP) Committee Response to the International Ethics Standards Board for Accountants (IESBA) Exposure Draft: *Proposed Revisions Pertaining to Safeguards — Phase 2 and Related Conforming Amendments*

INTRODUCTION

The SMP Committee (SMPC) is pleased to respond to the IESBA (the Board) on this Exposure Draft (ED). The SMPC is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small-and medium-sized entities (SMEs). The constituents of the SMPC are small-and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members of the SMP Committee have substantial experience within the accounting profession, especially in dealing with issues pertaining to SMEs, and are drawn from IFAC member bodies representing 22 countries from all regions of the world.

GENERAL COMMENTS

The SMPC has followed the Safeguards project and provided comment letters for the Board and Task Force's consideration as it has progressed over time.

Whilst the ED includes many requirements expressed more clearly, there are also instances in the ED where proposed revisions of subsections of the extant code mean that certain sections would become invariably longer with the repetition introduced. Subsection 607 provides such an example. The Explanatory Memorandum also mentions the notion of (unnecessary) repetition between the IESBA Code and ISQC 1 and ISAs. The SMPC believe that there is still material that could be streamlined or removed to reduce unnecessary duplication.

The SMPC had hoped that the IESBA would have taken this opportunity to address concerns raised by SMPs (as noted in paragraphs 3 and 15 of the Explanatory Memorandum) more thoroughly. Indeed, the notion of independence as an enabler of objectivity as opposed to as an end in itself could have been given more thorough consideration from an SME audit/ review perspective. The circumstances and thus public interest perspectives of many SMEs may differ considerably, not only when comparing with those of larger PIEs, but even within the non-PIE sector itself such that the need for, as well as what constitutes an appropriate degree of independence (and especially independence in mind), will differ from one assignment to another. We note that the fifth bullet point of para. 600.4 A3 does acknowledge that perceptions as to the level of threat may differ depending on whether an audit client is a PIE or otherwise. However, given the wide diversity in non-PIE clients, this is an overly simplistic distinction, especially as the IESBA Code is intended for global application. Whilst the exercise of professional judgment, which by its very nature has to take into account the individual engagement type and circumstances in assessing the list of factors in 600.4 A3, may go some way to addressing this, it would be very helpful if the Code were to discuss the



issue upfront and also, more extensively. As a matter of priority, we encourage the IESBA to include an explicit acknowledgment that in exercising professional judgment to determine the significance of any threat to independence (R600.4) the circumstances of the specific engagement will impact the relative weighting and interaction of such factors.

SPECIFIC COMMENTS

We have outlined our responses to each question (*in italics*) in the ED below.

Section 600, Provision of Non-Assurance Services to an Audit Client

1. *Do respondents support the proposals in Section 600? If not, why not?*

In particular, do respondents agree with the proposal to extend the scope of the prohibition on recruiting services to all audit client entities? If not, please explain why.

The SMPC has some concerns with the proposals. These are outlined in more detail below.

Para 600.2 – Scope

In its entirety, the Code is concerned with the accountants' compliance with the fundamental principles. However, Part 4A deals solely with independence for audits and reviews. The introductory text in paragraph 400 et seq. clarifies that Part 4A relates to independence, and compliance with the fundamental principles that are linked to independence (which according to Para 120.12 A1 are objectivity and integrity). We therefore do not see the necessity to add a reference to the possibility of threats to compliance with the fundamental principles beyond independence for individual themes addressed in Part 4A. Indeed, we are concerned that this additional text will introduce confusion.

We further note that this proposed wording goes beyond the extant Code. Specifically, the proposed second sentence of paragraph 600.2 reads "Providing non-assurance services to audit clients might create threats to compliance with the fundamental principles and threats to independence." This text is noted as derived from 290.154 of the extant Code which reads "Providing non-assurance services may create threats to the independence of the firm or members of the audit team". Indeed, beyond potentially impairing objectivity, we fail to see how the provision of NAS might impact the Code's remaining fundamental principles. For example, how might NAS threaten compliance with the principles of confidentiality or professional competence and due care? Thus, we would suggest that Para 600.2 be amended to read "Providing non-assurance services to audit clients might create threats to independence." The same rationale will also apply to Para 950.2

Para R600.4 – Application to all NAS

When R600.4 is read in conjunction with 600.4 A2, it becomes clear that the overriding requirement to determine whether a NAS would or would not create a threat applies to each and every NAS that a firm may be engaged to provide; not only those specifically dealt with in subsequent paras under section 600. However, implications for the firm or network's documentation of such determination have not been



addressed. A lack of application material on the extent of documentation is not helpful, since others including regulators, peer reviewers etc. will make their own demands in this area.

From an SMP perspective in particular, excessive documentation that uses resources otherwise available for engagement performance is undesirable. At a minimum, it would be helpful for the IESBA to acknowledge that documentation should be appropriate to the engagement circumstances, for example, a note of a “no significant threat” determination may suffice in some cases. Whereas for highly contentious services, it may be appropriate to document reasons, but that a check list weighing up all the factors listed in 600.4 A3, in some cases against one another, may only be appropriate in respect of NAS of high significance.

We would like to point out that the IAASB’s ISQC 1.21 et seq. require firms to “establish policies and procedures designed to provide the firm with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements maintain independence....”.Therefore it is not appropriate for the IESBA to give the impression that a higher degree of precision is indeed attainable.

Para 600.4 A3 – Factors that are relevant in evaluating the level of threats created

Larger entities may employ individuals with expertise in specific areas, whereas an SME’s employees and management will often comprise so called “all-rounders”. Thus, in practice, many small businesses may lack the (higher) degree of internal expertise, which might reasonably be expected to exist in larger entities. Proposed 600.4 A3 refers to the level of expertise of the client’s employees with respect to the type of service provided as a factor relevant to the evaluation of the level of threat that may be created by providing a non-assurance service to an audit client. This would logically appear to imply that the higher the level of expertise, the lower the threat to auditor independence, and conversely the lower the expertise, the higher the threat, although this is not explicitly clarified as such in the ED. If this interpretation is what the IESBA intended, then SME auditors are likely to be at a general disadvantage, unless the IESBA can provide appropriate clarification to address this.

The SMPC re-iterates that the application of the related safeguards to mitigate the threats identified through the evaluation of all the factors as indicated in Para 600.4 A3 is highly dependent on whether the client is a PIE or otherwise. Hence, the Board should consider giving more prominence to this factor as compared to the others. Furthermore, it could assist understanding if more examples can be provided under each of the factors listed.

Para R600.8 – Risk of assuming management responsibility

Proposed R600.8 follows extant paragraph 290.162 in specifically requiring the firm (or network firm) to ensure that the client’s management delegates an individual who possesses suitable skill, knowledge and experience to be responsible at all times for the client’s decisions and to oversee the (non-audit) service as a safeguard to address the risk of assuming management responsibility when providing any non-assurance service to an audit client. This section also clarifies that that individual is not required to possess the expertise to perform or re-perform the services.



In our view, the IESBA should clarify what the requirement in R600.8 for the auditor to “ensure” is intended to mean in practical terms in this context. The auditor cannot “force” a client to designate a person with a particular set of skill, knowledge and experience – certainly not when unavailable to the client. Beyond considerations of how “ensuring” is to be evidenced, the implication is that where the auditor cannot ensure this skill-set is present in the individual, the auditor would fail the “test” that would permit provision of the service. Consequently, unless a different interpretation of “ensure” is intended, the provision of services to many SME audit clients would be prohibited.

In practice, in many cases concerning SMEs, the client does not have, or desire to have, such a designated person, because the client intends to place a certain degree of trust in the auditor, whilst retaining decision making about the service and its outcome. In addition, in an SME environment supervisory elements are not very common, as they are inevitably related to additional costs and in most cases are usually undertaken by the proprietor or owner-manager. We agree that an express acknowledgement of client responsibility for decision making and overseeing the services should remain the key focus of the requirement. We also accept that it is reasonable to require an individual to understand the objectives, nature and results of the services as well as the respective client and firm responsibilities. However in an SME context, we believe it will generally be excessive and counterintuitive to specifically require “suitable skill, knowledge and experience” in an individual to be designated to these tasks.

Consequently, we would strongly encourage the IESBA to take the opportunity to revisit and amend the existing text, specifically by moving the material detailing the personal attributes (skill, knowledge and experience) of a designated individual to application material instead. If not, there needs to be an explicit recognition within the Code that any skill-set be appropriate to the service and what can be reasonably expected of the particular client in relation to that service. As it currently drafted, paragraph R600.8 could potentially prohibit the provision of many services to SME audit clients.

Para 604 – Taxation services

Para 604.7 A2 proposes that tax calculations be undertaken by a tax professional that is not a team member (also in 604.10 A2) as a safeguard. In SMPs, the tax calculations will almost always be computed by a team member, because there are no special tax professionals (i.e. no tax department like in big audit firms) and the team member knows the client and has the knowledge about specific facts that have to be accorded specific treatment in the tax returns. In the smallest firms, there may not be a professional who is not a team member and even where there is such a person available, synergies could be lost and costs unnecessarily increased to the extent that it will render such assignment unviable. In other jurisdictions, this may also not be possible because of the limited number of appropriately qualified personnel. Unless the tax is of a particularly contentious nature (usually, not for an SME), the risk of material misstatement ensuing from a self-review threat ought to be relatively insignificant. Where this is not the case, we agree that a safeguard would be appropriate.

Delineation of Requirements and Guidance

The proposed delineation between requirements and application material needs to be considered more carefully in some instances. Specifically, given the significance of the statement in 600.7 A4 for the SMP



community in particular, and its relevance in understanding the requirement of R600.7, we suggest this to be more prominently located - preferably added as a second sentence to R600.7.

In many instances, the Board has proposed a short requirement separate from the safeguards, usually placing the latter within the application material. In contrast, R606.5 offers a mix of both requirements and safeguards within the same paragraph. We believe the Board should be consistent.

In addition, it appears that the new text in 600.6.A1 whilst ostensibly application material, actually requires an additional consideration of the combined impact when a firm or network provides more than one NAS. This new consideration appears to be in addition to the consideration of each NAS in isolation. Such consideration could potentially be onerous and highly subjective especially as IESBA's intent in this context remains unclear. For example, it would be counterproductive to require the firm to determine (and document) that individual safeguards can limit sufficiently the threats from individual NAS in isolation, if a combined consideration can be deemed to lead to the conclusion that the perception of the combined threat exceeds the perceived sum of the individual threats. Further clarification is therefore needed in this area from the Board.

The same observation here is also applicable for Para 950.7 A1.

Prohibition on recruiting services to all audit client entities

We do not believe that IESBA has made a case for the proposal to extend the provisions of paragraph 290.210 of the Code currently applicable to PIEs to all audits as proposed in R609.6. In the absence of any academic research, the SMPC has significant concerns and does not believe an across the board prohibition of recruitment services for key posts is warranted in all audit and review circumstances.

Recruiting services may vary considerably in terms of their significance to the audit or review. There is a significant difference between independence in fact, and independence in appearance, depending on whether the audit or review is provided for an entity. The fifth bullet point in 600.4 A3 acknowledges this fact. Generally, there is little public interest impact for SMEs, which would result in perceptions about lack of independence. In addition, usually the owners or proprietors of SMEs tend to be more 'hands-on' and thus, the risk of assuming management decision making by the auditors in this context is very much reduced. SMEs often will not have sufficiently qualified personnel possessing the ability to recruit suitably qualified individuals for the key positions contemplated in R609.6. An SME's auditor may well be the best suited person to be able to advise on the necessary profile and experience of potential candidates; especially for positions such as the CFO.

In practice, we understand that it is quite common to involve the auditor in such an advisory capacity during the recruiting process. Thus the material in 609.3 A1 ought to continue to serve as an essential clarification in a non-PIE context. Paragraph 609.1 points out that such recruiting services create a self-interest, familiarity and intimidation threat. In our view, if the auditor is involved in the recruiting process, e. g. selecting various candidates, but not in making a management decision, the threat is not of the magnitude that the IESBA proposal implies. Indeed, assisting in the selection of suitable candidates does not create any threats to the auditor's independence, but instead provides helpful assistance to the client. We accept



that there would be a significant threat if the auditor assumed ultimate responsibility for a recruitment decision.

As an alternative, the Board could provide a list of factors in the Application Material that ought to be considered by a practitioner when accepting or continuing an engagement to provide recruitment services to an audit client. This would facilitate the practitioner to use their professional judgment to determine whether to accept, or to continue with, the engagement, rather than an outright prohibition of such services. It would assist the practitioner in identifying possible threats that might be encountered while providing such services and to take the most suitable action(s), including the application of safeguards, or to withdraw from the engagement where appropriate.

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

2. Do respondents support the proposals in Section 950? If not, why not?

Similarly with Section 600, the SMPC has concerns with the proposals in Section 950. In particular, the Scope and Delineation of Requirements and Guidance.

In addition, observations raised under Para R600.4 (Application to all NAS) and Para R600.8 (Risk of assuming management responsibility) are equally relevant to Section 950.

Ultimately, when it comes to requirements, it is a matter of expectation and, by extension, the eventual impact on documentation. The IESBA should consider the circumstances in which SMPs operate. If requirements like client acceptance checklists (as an example) was to exceed a certain format as part of the evaluation process, it will disproportionately burden the SMPs.

Examples of Safeguards

3. Do respondents have suggestions for other actions that might be safeguards in the NAS and other sections of the Code that would meet the revised description of a safeguards?

As noted above, the circumstances for non-PIE clients are very different for those pertaining to PIE clients, particularly in terms of independence in appearance, which are often driven by perceptions. Indeed, reading the proposed revised text as a whole gives the overall impression that there are many factors to take into account in assessing (and by implication, documenting) threats, quite a few threats that can only be dealt with effectively by (documenting them and introducing) prohibitions and relatively very few safeguards that can be applied to reduce threats.

We are concerned that in narrowing the range of safeguards in the way IESBA is now doing to focus only on measures put in place by the firm, and counting factors in the environment as relevant only to the evaluation of the level of threats, may bias the public perception of the effective mitigation of threats, to the detriment of the profession's reputation. The notion that external factors and acceptance by those charged with governance are no longer safeguards for firms have a significant impact on an SMP/SME environment and will take time to become accepted by the business community at large.



Conforming Amendments Arising from the Safeguards Project

4. *Do respondents agree with proposed conforming amendments set out in: (a) Chapter 2 of the ED document on the Safeguards project; and (b) The gray text in Chapters 2–5 of Structure ED-2 project's ED document?*

The deletion of the third bullet point in 310.8 A3 is not appropriate as far as the fundamental principle of professional competence and due care is concerned when facing a conflict of interest. Recourse to a professional body, legal counsel or another accountant will certainly be perceived by the public as an appropriate measure in certain circumstances.

The proposed introduction of the term “questionable issues” in 320.4 A2 may be problematical without further clarification of what it means in a practical sense. It may also be difficult on translation. In addition, it leads to the question of whether in the absence of questionable issues, there is a need to consider client commitment in this area.

Any Other Comment(s)

5. *Respondents are asked for any comments on any other matters that are relevant to Phase 2 of the Safeguards project.*

The Explanatory Memorandum mentions the notion of (unnecessary) repetition between the IESBA Code and ISQC 1 and ISAs. The SMPC believes that these materials could still be streamlined or removed to reduce the duplication.

Para 320.6 A3 may be problematical in some jurisdictions where client confidentiality requirements may require client permission for auditors to exchange information unless prescribed for in law. This should be acknowledged in the Code.

CONCLUDING COMMENTS

We hope the IESBA finds this letter helpful in informing the Board's deliberations on the Phase 2 of the Safeguards project. Please do not hesitate to contact me should you wish to discuss matters raised in this submission.

Sincerely,

A handwritten signature in blue ink that reads "Monica Foerster". The signature is written in a cursive, flowing style.

Monica Foerster
Chair, SMP Committee