



BY E-MAIL ONLY

International Ethics Standards Board for Accountants

To: Prof. Stavros Thomadakis (Chair)

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Date: May 29, 2017

Subject: COMMENTS ON THE IESBA PROPOSED REVISIONS PERTAINING TO SAFEGUARDS IN THE CODE—PHASE 2

Dear Prof. Thomadakis,

1. The International Forum of Independent Audit Regulators (IFIAR) appreciates the opportunity to comment on the International Ethics Standards Board for Accountants (IESBA) request for input on “Proposed Revisions Pertaining to Safeguards in the Code—Phase 2 and Related Conforming Amendments”. As an international organisation of independent audit oversight regulators that share the goal of serving the public interest and enhancing investor protection, IFIAR is committed to improving audit quality globally through the promotion of high-quality auditing and professional standards, as well as other pronouncements and statements.
2. The IFIAR’s objectives are as follows:
  - Sharing knowledge of the audit market environment and practical experience of independent audit regulatory activity, with a focus on inspections of auditors and audit firms.
  - Promoting collaboration and consistency in regulatory activity.
  - Initiating and leading dialogue with other policy-makers and organisations that have an interest in audit quality.
  - Forming common and consistent views or positions on matters of importance to its members, while taking into account the legal mandates and missions of individual members.



3. The comments we provide in this letter reflect the views expressed by many, but not necessarily all, of the members of the IFIAR. However, the comments are not intended to include, or reflect, all of the views that might be provided by individual members on behalf of their respective organisation.
4. Where we did not comment on certain specific matters this should not be interpreted as either approval or disapproval by the IFIAR.
5. The IESBA Code of Ethics (the Code) is used by some IFIAR members, but not by all of them. Moreover, a number of audit firms have voluntarily committed to complying with the Code. As a result, the IFIAR has an interest in enhancing the quality, clarity and enforceability of the Code.
6. As audit regulators, we believe that the Code should be clear and enforceable and allow for audits to be performed on a consistent basis. The Code should incorporate provisions required to ensure appropriate and consistent auditor behaviour.
7. We also believe that consideration of the public interest, including the needs of investors and other users of financial information, should drive this project.
8. As mentioned in previous IFIAR comment letters, we support IESBA's project to enhance provisions and clarity regarding safeguards. This being said, regarding this part of the "safeguards" project which deals with non-audit services, we strongly suggest the Board consider wider revisions for stronger requirements in the non-audit services section in the Code.
9. The most recent IFIAR inspection survey<sup>1</sup> indicates a high number of findings relating to independence and ethical requirements, most of which refer to failure to consider and evaluate non-audit services provided to the audited entity.<sup>2</sup> While inspection findings indicating that some auditors have failed to comply with standards in a particular area, do not necessarily indicate a problem with those standards, we encourage IESBA to strengthen the Code in the area of the provision of non-audit services, where findings are frequent.

***Further revisions of the provisions on non-audit services are needed***

10. We have observed an increasing trend globally whereby jurisdictions have strict prohibitions against the performance of certain non-audit services along with a "threats and safeguards" approach. Therefore, we strongly suggest the Board consider stronger prohibitions in the current proposals for non-audit services to enhance the effectiveness and international usefulness of the Code.

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<sup>1</sup> IFIAR, *2016 Inspection Findings Survey Report*, available via this [link](#).

<sup>2</sup> Idem, page B-3: "Independence and Ethical Requirements, 72 findings in total, of which 23 relate to failures to consider and evaluate non-audit and/or audit-related services provided to the audited entity."



11. In particular, we believe that, in the current context, some non-audit services should not be permissible since they create familiarity and self-review threats. For example, the non-permissible services should at least include bookkeeping services and some administrative services, but potentially also other services. We urge IESBA to initiate a project to review non-audit services that are prohibited in individual jurisdictions to determine what further prohibitions should be made to the Code in order to enhance its effectiveness.
12. Furthermore, we believe it is important that the professional ethical standards for auditors are relevant and responsive to the evolutions<sup>3</sup> in audit and especially in the field of non-audit services. We draw the Board's attention to the fact that the Code should be able to adapt to and to respond to the rapid changes in the types of non-audit services the auditor might wish or might be requested to provide. To that end, the non-audit services sections of the Code should include sufficiently strong provisions to provide direction for new types of services.

### ***Safeguards described are insufficiently specific and potentially ineffective***

13. In the current draft, the examples<sup>4</sup> of actions that might be safeguards are similar or the same for all services and threats, irrespective of the appropriateness and specificity of the type of services envisaged. We believe that the safeguards applied should be responsive to the specific threat that they are intended to mitigate. In addition, we do not believe it would be a sufficient safeguard in all cases to use professionals who are not members of the firm's audit team to provide the non-audit service, or, if the work is done by a member of the audit team, having another professional outside the audit team review the work. We encourage the Board to add specificity to the description of safeguards that are appropriate to mitigate the risk in providing the particular type of non-audit service.

### *Situations where no safeguards would be effective should be described*

14. As we previously commented (see appendix - IFIAR letter dated 10 May 2016, par 11.), we encourage the Board to identify those situations where no safeguards can be provided to address the threats that would be created by the provision of non-audit services. In those situations, the auditor should not deliver the services envisaged.

### ***Other important comments***

#### *Concepts like "materiality" or "significance" impair the effectiveness and enforceability of the Code*

15. The proposal includes factors that are relevant for the auditor in evaluating the level of threats related to non-audit services. One of those factors is related to the "material" effect of the services provided

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<sup>3</sup> IFIAR recognised the increased trend globally whereby more jurisdictions are including strict prohibitions against the performance of certain non-assurance services.

<sup>4</sup> In some areas of the Code (e.g. 540.4.A3, 905.4.A2, 924.5.A2)



on the financial statements. A reference to ISA 320 dealing with “materiality” in an audit of financial statements is provided (in paragraph 600.5.A1), but no other indication about how to assess the material effect of services is provided in the Code. We believe the concept of “materiality” should be avoided, because even immaterial non-audit services could impair independence.

16. However, if maintained in the Code to evaluate the threat to independence, we believe more specific descriptions are needed to reach a consistent application of this concept and to prevent abuse. The same difficulty has been identified in relation to what is considered to be ‘significant’ allowing the auditor to assess the threat to independence as low in cases where services are not “material” or “significant”, without further explanation of what those terms mean, impairs consistent application of the Code. We encourage the Board to reconsider the use of the concept of “significance”.
17. The concept of “significance” is also used in relation to some other services (internal audit (605.4.A1/R605.7) and information technology services (R606.5/R606.6)), which impairs the effectiveness of the provisions. We believe further explanations also would be necessary to allow for consistent application of this notion of “significance”.

#### *Exceptions have a weakening impact on the Code*

18. We believe that providing exceptions to the provisions of the Code regarding non-audit services impairs the clarity and robustness of the Code. We encourage the Board to avoid the exceptions when the rationale behind those exceptions is not clear and fully justified.<sup>5</sup>

#### *Taking into account the effect of multiple services*

19. We agree that the combined effect of the provision of multiple non-audit services should be taken into consideration to assess the threats on the independence of the auditor (par. 600.6 A1), but believe that this should be a requirement in the Code rather than included solely in the application material.

#### *Scope of the provisions should be clarified*

20. The Code should be clearer on whether the provisions described in revised section 600 (and subsections) are applicable to the audit firm and the network firms in all instances, and on whether the provisions on non-audit services in the Code apply to both services provided to the audited entities and related entities (subsidiaries and parent companies).
21. In particular, we disagree with the exception which allows the auditor to provide prohibited non-audit services and to assume management responsibilities for related entities of the client (described in R600.10) (see also our comment on the need to avoid exceptions).

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<sup>5</sup> Examples of adding exceptions can be found in R600.10 and R601.8



*Avoid management responsibilities*

22. We believe insufficient clarity is provided for avoiding management responsibilities. In particular, we believe that the difference between providing advice and recommendations versus assuming management responsibilities is difficult to distinguish in practice. Thus we do not support the statement (in par.600.7.A4), which seems to convey the message that advice and recommendations are always acceptable. Providing advice and/or recommendations can create self-review threats which may well impair the auditor's independence, and should be evaluated depending on the particular circumstances.

*Previous comments on safeguards project - phase 1*

23. In addition, we note that some of our prior comments<sup>6</sup> regarding (i) addressing threats and (ii) clarification of timing of re-evaluation of threats and overall assessment have still to be addressed. We continue to ask the Board to address these comments before finalising the safeguards project.

*Need for post-implementation review*

24. We encourage IESBA, following completion of this project, to gather stakeholder input via a post-implementation review in order to assess whether the changes have achieved the desired effects (e.g. whether the goals have been met and whether some challenges remain).

Should you wish to discuss any of our comments, please do not hesitate to contact me or Marjolein Doblado, Chair of the IFIAR Standards Coordination Working Group.

Yours Faithfully,

Brian Hunt  
IFIAR Chair

Cc: Frank Schneider, Vice Chair,  
Marjolein Doblado, SCWG Chair,  
Carl Renner, Executive Director

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<sup>6</sup> See appendix.



## Appendix: Excerpt from IFIAR Comment Letter dated May 10, 2016

(...)

### *Addressing Threats*

11. The proposals indicate, in the application material<sup>2</sup> and examples<sup>3</sup> that situations exist where the threat created would be so significant that no safeguards could reduce it to an acceptable level, and that the professional accountant would have no option but to decline or discontinue the engagement. We believe that more emphasis should be placed on those situations, and that those cases should be dealt with in the requirements of the Code: an obligation for action should be attached to those cases.

### *Clarification of Timing of Re-Evaluation of Threats and Overall Assessment*

12. We do not believe that a re-evaluation of threats should be restricted to the emergence of new information, but rather as a constant state of awareness. We believe the professional accountant should at least engage in periodic re-evaluation of threats on a timely basis to evaluate new information or potential changes in facts and circumstances.

13. Similarly, we note that it is unclear in the proposals when the overall assessment<sup>4</sup> should be performed. Provisions on timing should be added in this regard.

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<sup>2</sup> Safeguards ED proposed paragraph 120.7 A1.

<sup>3</sup> IESBA restructured Code sections CI and C2.

<sup>4</sup> Safeguards ED proposed paragraph R120.9.