



International Organization of Securities Commissions
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2 June 2016

Technical Director
International Ethics Standards Board for Accountants
545 Fifth Avenue, 14th Floor
New York, NY 10017 U.S.A.

Our Ref: 2016/JE/C1/IESBA/19

Subject Line: IESBA's Exposure Draft, *Proposed Revisions Pertaining to Safeguards in the Code—Phase 1*

Dear Sir:

The International Organization of Securities Commissions' Committee on Issuer Accounting, Audit and Disclosure (Committee 1) appreciates the opportunity to comment on the International Ethics Standards Board for Accountants' (the IESBA or the Board) Exposure Draft, *Proposed Revisions Pertaining to Safeguards in the Code—Phase 1* (the Paper). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through the promotion of high quality accounting, auditing and professional standards, and other pronouncements and statements.

Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting, disclosure and auditing concerns, and pursuit of improved global financial reporting. Unless otherwise noted, the comments we have provided herein reflect a general consensus among the members of Committee 1. Our comments are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.



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Overall Comments

We appreciate the Board undertaking what we see as establishing a general framework for accountants to consider threats to their compliance with the fundamental principles set out in the Code. However, we had different overall reactions to what the Board was proposing for the general framework in Section 120 as compared to the illustrative material for professional accountants in public practice, which is included in Section 300.

Section 120 seems to provide a workable general framework although we had some comments and suggestions on the proposed text as noted later in the letter. In particular, whereas the proposed definition of a reasonable and informed third party test has merit, we have provided comments below related to its enforceability. Further, we suggest that this framework may be better titled a “general framework” rather than a “conceptual framework” because it establishes the approach that the Code will require accountants to take in assessing threats.

With respect to Section 300, we are unclear as to its proposed function because it does not establish any new requirements for professional accountants in public practice rather it seems to provide illustrative information regarding threats that those accountants may encounter. The proposed amendments suggest that definitions are categorized as application material. We urge the Board to revisit this, given their importance in the understanding of the Code. Will the Board establish specific requirements for professional accountants in public practice in Phase II of the project and if so, how will this illustrative guidance be incorporated therein? Provided specific requirements are included in Phase II, we look forward to providing comments at that time. In the interim, we have conveyed some general thoughts from our experiences at the end of our letter for the Board’s consideration.

Phase II of the Project

We believe one of the challenges facing the Board is fostering the behavior of professional accountants so that they consistently act in the public interest. We believe that one of the outcomes of the current threats and safeguards approach has been a tendency for professional accountants to rely on a safeguard when a violation of the Code has occurred rather than have a possible engagement termination-first mindset. To address this pattern of behavior it may take more than some adjustments to the language within the Code. As indicated previously in



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our comment letter dated the 3rd of October, 2014, in response to the Board's Exposure Draft in addressing Non-Assurance Services for Audit Clients, we indicated that we looked forward to the Board's broader projects, such as the Structure of the Code and revisiting the threats and safeguards approach to address the more significant public interest concerns regarding the enforceability, clarity and the appropriateness of the threats and safeguards approach in the Code.

In this regard, we noted that the Paper does not articulate how specific safeguards address specific instances of non-compliance. As such, we think it is challenging for users and enforcers of the Code to visualize what the actual changes will be and the possible effect these changes will have on the behavior of the professional accountant. Is it the Board's intent to propose specific changes to Section 300 in Phase II of the project?

We believe that regardless of the proposals the Board puts forth in the Paper or in Phase II of the project to strengthen the Code such proposals may be somewhat mitigated if the Code continues to allow for exceptions to the requirements. We believe exceptions allowed by the Code should be limited, if not eliminated, so that professional accountants maintain the appropriate level of independence and objectivity that investors and users of such reports expect.

The Proposed Conceptual Framework (Section 120)

Reasonable and Informed Third Party

We note that the Paper defines Reasonable and Informed Third Party as follows:

“The concept of a reasonable and informed third party is a test which involves an evaluation by a hypothetical person. Such a person possesses skills, knowledge and experience to objectively evaluate the appropriateness of the professional accountant's judgments and conclusions. This evaluation entails weighing all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time that the evaluation is made to determine whether the accountant complies with the fundamental principles.”

We believe the proposed definition appears to concentrate on the “informed” part of the concept, that is, a person who possesses “skills, knowledge and experience”. However, the



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Board should provide additional clarity on the characteristics this person possesses. For example, the Board may wish to indicate that this person is expected to have a reasonable knowledge of business and economic activities, has a general understanding about auditing and is expected to be diligent in their review and analysis of the relevant information.

We also believe the Board could go further with respect to the “reasonable” part of this concept. More specifically, an independent third party is not just another professional accountant but someone who is unrelated to the audit and/or network firm or the audited entity in fact and appearance, who considers the specific facts and circumstances and concludes in a manner that is devoid of bias. One additional element the Board may wish to consider in assessing the accountant’s objectivity as part of the “reasonable” concept is whether the outcome of the accountant’s decision could have any bearing on the judgment exercised by those charged with governance, as they are representing the interest of investors.

Addressing Threats

We believe that non-compliance with the fundamental principles should be regarded with the utmost severity such that the professional accountant’s first inclination is to discontinue the service/relationship or resign, as appropriate. Exhibiting this termination-first mindset in addressing threats can promote compliance with the Code, not just in the letter of the law but in the spirit of the rules. The Board should encourage professional accountants to have a mindset that does not view safeguards as the primary approach.

In addition, we have observed that paragraph 120.7 A1 states that:

“There are some situations where the threat created would be so significant that no safeguards could reduce the threat to an acceptable level. International Independence Standards C1 and C2 of the Code provide examples of such situations.”

While we agree with the first sentence in paragraph 120.7 A1, we believe the message that the Board should also communicate is that there are certain occurrences of non-compliance for which no safeguards should even be considered. Examples of these include an intentional or severe breach of the fundamental principles or for example, a breach of an independence requirement that is not inconsequential and involves a key audit partner and/or manager-level individuals within the firm who are responsible for overseeing the engagement.



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While paragraph 120.7 A1 points to certain situations where the threat created would be so significant that no safeguards could reduce such a threat to an acceptable level, we believe the reference to such threats in the International Independence Standards C1 and C2 of the Code is vague. More specifically, it is not clear to us which situations in the International Independence Standards C1 and C2 compels the public accountant to conclude that no safeguards could reduce a threat to an acceptable level or moreover compel the public accountant to conclude that no safeguards are ever available for certain instances of non-compliance. We believe the Board should strengthen the provision in paragraph 120.7 A1 to specify those instances of non-compliance with the Code for which the Board has predetermined that safeguards should not even be a consideration. Further, this paragraph should be communicated earlier in the Paper and with greater authority than its current placement as “Application Material”. Perhaps this message could be inserted prior to paragraph R120.3 – Requirements and Application Material.

Definition of Safeguards

We note that the Paper defines safeguards as “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.” We believe the definition should emphasize the actions are intended to eliminate “specific threats” to compliance with the fundamental principles or reduce them to an acceptable level. Further, as part of the definition of safeguards, the Board should also consider the inclusion of actions taken by the issuer to eliminate or reduce specific threats.

Re-evaluating Threats

We agree with paragraph R120.8 which states that:

“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”.

However, we do not believe that a re-evaluation of threats should be undertaken only if new information emerges or if there has been any change in the facts and circumstances. We believe the Paper should require the professional accountant to engage in periodic re-evaluation of threats at intervals that the Board deems reasonable *to determine* if any new



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information has emerged or if there has been any change in the facts and circumstances. Having said this, the level of frequency of periodic re-evaluation might vary based on the nature of the services provided or relationship between the professional accountant and the issuer. For example, threats to objectivity may necessitate a different frequency of re-evaluation than threats to professional competence.

Overall Assessment

We commend the Board for including in the Paper the concept of an overall assessment consistent with input we provided to the Board in our 30 January 2015 comment letter. We believe that after having complied with the standard-specific requirements, the overall assessment provides an opportunity for the professional accountant to step back and determine whether the professional accountant is conforming to the spirit of the fundamental principles based on the facts and circumstances. However, we note that the Paper is unclear with respect to *when* the overall assessment should be performed (paragraph R120.9). Provisions on timing should be added in this regard.

Application of the Conceptual Framework (Section 300)

We note that paragraph 300.2A9 states that:

“Safeguards vary depending on the facts and circumstances. The following 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 otherwise 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 otherwise 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.



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- Consulting 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...”

We note the first three examples in paragraph 300.2 A9 appear to involve using other professional accountants in the same firm (who were not part of the engagement team providing the services) to review the work performed by such engagement team. We question whether this is an appropriate safeguard given the self-interest and self-review threat that also exists on a firm-wide basis. For example, if the firm has provided a non-audit service that will be subject to audit, the firm is not independent, and so the three actions described above would not constitute suitable safeguards for an audit engagement in those circumstances. We are concerned that the language and implicit message would lead the public accountant to conclude that self-interest and self-review threats are only confined to the individuals on an engagement team, rather than to the entire audit and/or network firm itself.

With respect to the fourth safeguard noted in paragraph 300.2 A9, we do not agree that the mere action of consulting is an adequate safeguard in itself. Receiving and implementing relevant feedback addressing specific threats as a result of consulting with those charged with governance or other independent third parties would be more appropriate to include as a safeguard.

Thank you for the opportunity to comment on the Paper. If you have any questions or would like to further discuss these matters, please contact either Nigel James or me at 202-551-5300.

Sincerely,

Julie A. Erhardt
Chair, Committee on Issuer Accounting, Audit and Disclosure
International Organization of Securities Commissions