

Mr Ken Siong
International Ethics Standards Board for Accountants
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

25 April 2017

Dear Mr. Siong,

Proposed Revision Pertaining to Safeguards in the Code – Phase 2

We are pleased to comment on the Exposure Draft *Proposed Revisions Pertaining to Safeguards in the Code – Phase 2 and Related Conforming Amendments*. We continue to support the Board’s continued efforts to update the Code and the development of an enhanced and more robust conceptual framework including improvement to the clarity, appropriateness and effectiveness of the safeguards in the Code.

We agree with the Board’s determination in the Basis for Agreement in principle - Phase 1 document to adopt the three step (identify, evaluate and address) approach to the conceptual framework which gives greater clarity to the approach to be adopted by Professional Accountants. Additionally, we are pleased to note that the requirement to re-evaluate threats is a now sub-heading to the section entitled “Evaluating Threats” and is not an additional stage in the conceptual framework and that the wording in the Phase 1 draft on the “Overall Assessment” has been removed.

We support the clarifications and refinements in the Exposure Draft to explain that many of the examples of safeguards are in fact “actions that might be safeguards” to address the threat caused by providing the specific type of NAS. We understand that the overall purpose of this change is to refocus professional accountants on other actions that might be more appropriate to address specific threats. We also believe that it will remind accountants that the mere application of a safeguard might not be sufficient to address a threat as the current wording in the Code may suggest. However, as noted below we believe that the word “can” rather than “might” is more appropriate in expressing the probability or possibility that a safeguard is appropriate.

Clear and explicit statements are now included in the revised text which sets out 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. We believe that such statements serve to highlight that safeguards may not in all cases be sufficient to address an independence threat. It is helpful that such statements are located in a prominent position within the introduction to each of the relevant NAS subsections.

Five specific questions were identified on which the Board welcomed respondents' views and we have organized our response accordingly. Our comments are set out below.

Request for specific comments

Proposed Revisions Pertaining to Safeguards I the Code – Phase 2

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

Yes. In general we agree with the proposals in Section 600 and consider that the revisions made by the Board as part of the Phase 2 project have further strengthened the clarity and structure of the Code. However, we have a number of specific comments which are set out below.

Use of the term “might”

As explained in the Agreed-in-Principle document, *Improving the Structure of the Code of Ethics for Professional Accountants – Phase 1 and Proposed Revisions Pertaining to Safeguards in the Code - Phase 1*, dated January 2017 the Board has decided to use the word “might” to replace “may” in certain situations:

“when the term ‘might’ is used in the Code it denotes the possibility of a matter arising, an event occurring or a course of action being taken”.

We consider that the use of the word “might” versus “may” appears to weaken the requirements re identifying threats to independence. Many technical resources regarding English language suggest that “might” is normally viewed as suggesting something more remote than “may”. For example, Merriam-Webster indicates that “might” suggests “less probability or possibility” than “may”. Where the substitution of “may” with “might” appears to function in the sections presented in Phase 1 of Safeguards and Structure projects project, it appears inappropriate in the context of Section 600 and non-audit services as it appears to understate the true level of risk that such a threat may exist. For example, the statement “Providing valuation services to an audit client might create self-review threats” appears to suggest that a self-review threat would be remote when in reality it is likely in most situations.

We suggest using some other wording that reflects more accurately the risks of threats occurring. The Merriam-Webster dictionary definition of “may” implies it can be used interchangeably with the word “can” which we consider is a better alternative to “might”. In the context of safeguards, the introduction of a conditional word such as “might” appears appropriate because it reminds the PA that the safeguard may not always be effective as a means of reducing a threat. However, the word “can” would seem to reflect more accurately the probability or possibility that the safeguard would be adequate.

Management responsibilities

We support placing “management responsibilities” as a dedicated section separate to “non-assurance services” as such responsibilities may be triggered by a number of NAS. We agree that the re-positioning of this material in Section 600 provides an enhanced prominence to this important overarching prohibition in the Code.

In addition to the above comments other detailed observations and suggestions for improvements are included in an attachment to this letter.

In particular, do respondents agree with the proposal to extend the scope of the prohibition on recruiting services as described in paragraph 25(h) above to all audit client entities? If not, please explain why.

Yes. We agree with the proposal to extend the scope of the prohibition on recruiting services as described in paragraph 25(h) to all audit client entities. We consider the self-interest, familiarity and intimidation threats posed by such recruitment activities applies equally for PIE and non-PIE audit clients and that the extension of the requirements to non-PIEs is in the public interest. In any case, the auditor continues to be able to play an important role, particularly in the SME segment, of interviewing candidates and advising on their suitability for a financial accounting, administrative or control position.

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

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

Yes. We support the proposals in Section 950. The attachment to this letter also addresses our observations and suggestions for improvement of this section.

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 safeguard?

No. We do not have any additional safeguards to those already set out in the Code.

Conforming Amendments Arising from the Safeguards Project

4. Do respondents agree with proposed conforming amendments set out in:
(a) Chapter 2 of this document.
(b) The gray text in Chapters 2–5 of Structure ED-2.

Yes. The attachment to this letter also addresses our observations and suggestions for improvement of these sections.

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

In multiple sections of the Phase 2 Safeguards exposure draft an example of an action that might be a safeguard to address the particular threat is to perform a review. The language used to describe this safeguard however varies from section to section and it is not always clear who should perform such a review. The language variations include “having a professional review”, “have a professional accountant review”, “having a professional accountant who is not a member of the assurance team review”, “having a professional accountant who did not take part in the assurance engagement review”, “an example of an action...is conducting a review” and “having an appropriate person review”. We recommend that the language used for this particular example of a safeguard be streamlined for consistency.

Sections 540.5 A1 and 540.5 A2 address the factors relevant to evaluating the level of threat for long association. The examples of actions that might be safeguards are however set out in section 540.4 A3. The order of these sections should be reversed so text related to threats precedes the text on safeguards. The same comment applies to sections 940.5 A1 and 940.4 A3.

Any other comment or observation on Phase 2 of the Safeguards project are included in the attachment to this response letter.

In addition to the request for specific comments above, the IESBA is also seeking comments on the matters set out below:

(a) Small and Medium Practices (SMPs) and PAIBs – The IESBA invites comments regarding any aspect of the proposals from SMPs and PAIBs.

No comment

(b) Regulators and Audit Oversight Bodies – The IESBA invites comments on the proposals from an enforcement perspective from members of the regulatory and audit oversight communities.

No comment

(c) Developing Nations – Recognizing that many developing nations have adopted or are in the process of adopting the Code, the IESBA invites respondents from these nations to comment on the proposals, and in particular on any foreseeable difficulties in applying them in their environment.

No comment.

(d) Translations – Recognizing that many respondents may intend to translate the final changes for adoption in their own environments, the IESBA welcomes comment on potential translation issues respondents may note in reviewing the proposals.

We continue to believe that certain jurisdictions will be challenged to translate all documents relevant to the overall restructuring project in order to provide timely and wholesome comments. If, as anticipated, the Board completes the restructuring of the Code in December 2017, with the earliest effective date (for most sections) being 15th June 2019 this would present many professional bodies with a relatively short 18 month window in which to translate, obtain feedback and approve an entirely revised Code.

The restructuring of the Code and the resulting changes to the conceptual framework introduce a whole new approach which will require time for regulators, firms and other interested parties to adopt and incorporate into their rules, regulations and policies. In addition to translation challenges, it is essential that IESBA allow sufficient time for all such parties to properly adopt and implement the required changes. We believe that an extension to the effective date should be considered to allow for a more consistent and robust adoption of the revised Code.

We would be pleased to discuss our comments with members of the International Ethics Standards Board or its staff. If you do wish to do so, please contact Bob Franchini (+39-02-72212014) or Lisa Whitlock (+44 207 951 5191).

Yours sincerely,

Ernst + Young Global Limited

Ernst & Young Global

Attachment: Detailed Observations

Exposure Draft Reference	Comments
R270.5	<p>Structure Phase 2 - Pressure to Breach the Fundamental Principles</p> <p>Section R270.5 of the Structure exposure draft addresses the application of safeguards without providing any examples. Examples of possible safeguards however appear to be included in the preceding paragraph 270.4 A6. As such, we recommend positioning R270.5 before section 270.4 A6.</p>
600.6 A1	<p>Multiple Non-assurance Services to an Audit Client</p> <p>We suggest adding additional language to align this text to the conceptual framework to properly address how safeguards should be applied in the event that multiple non-audit services are provided.</p> <p style="padding-left: 40px;">“A firm or network firm might provide multiple non-assurance services to an audit client. When providing a non-assurance service to an audit client, applying the conceptual framework requires the firm to <u>identify, evaluate and address</u> consider any combined effect of threats created by other non-assurance services provided to the audit client <u>by the firm or network firm.</u>”</p>
600.7 A1	<p>Avoiding Management Responsibilities</p> <p>We propose including the following language at the end of the first sentence of section 600.7 A1:</p> <p style="padding-left: 40px;">“Providing a non-assurance service to an audit client creates self-review and self-interest threats if the firm assumes a management responsibility <u>in performing such a service.</u>”</p>

Attachment: Detailed Observations

Exposure Draft Reference	Comments
R600.9 (c), R600.10(c)(iv)	<p>Providing Non-Assurance Services to an Audit Client that Later Becomes a Public Interest Entity , Considerations for Certain Related Entities</p> <p>We consider that the text in R600.9(c), R600.10(c)(iv) should be consistent as they are seeking to address the same matter but currently read differently.</p> <p>R600.9(c): The firm applies the conceptual framework to identify, evaluate and address any threats that are created</p> <p>R600.10(c)(iv): The firm applies the conceptual framework to eliminate any threats created or reduce them to an acceptable level.</p> <p>More generally there needs to be consistent use of the terms “identify, evaluate and address”, “evaluate and address” “eliminate” or “reduce to an acceptable level” throughout the Code in reference to the application of the conceptual framework.</p>
R600.10	<p>Considerations for Certain Related Entities</p> <p>We suggest the addition of the words in bold below to the second sentence of R600.10 due to the fact that the related entities listed in sections (a) to (c) are related entities only for public interest entity audit clients.</p> <p>“As an exception to those requirements, a firm or network firm may assume management responsibilities or provide non-assurance services that would otherwise be prohibited to the following related entities of the <u>public interest entity audit</u> client on whose financial statements the firm will express an opinion”</p>

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Exposure Draft Reference	Comments
601.3 A2	<p>Accounting and Bookkeeping Services</p> <p>We propose including the following edit to the 3rd bullet of section 601.3 A2 to align to the text in the extant Code:</p> <p style="padding-left: 40px;">“Originating or changing journal entries, or determining <u>or approving</u> the account classifications of transactions.”</p>
601.4 A1, 601.5 A1	<p>Accounting and Bookkeeping Services</p> <p>We propose that both these sections would be better placed after R601.6 in the text given their relevance to situations involving non-public interest entity audit clients.</p>
601.5 A1	<p>Accounting and Bookkeeping Services</p> <p>We suggest the following edit to the language in this section to clarify that such services are only permissible when routine and mechanical:</p> <p style="padding-left: 40px;">“Examples of actions that might be safeguards to address the self-review threats created when providing accounting and bookkeeping services <u>of a routine and mechanical nature</u> to an audit client include:...”</p>
R601.6	<p>Accounting and Bookkeeping Services - Audit Clients that Are Not Public Interest Entities</p> <p>We suggest the following edit to improve the structure of this section:</p>

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Exposure Draft Reference	Comments
	<p>“A firm or a network firm shall not provide to an audit client that is not a public interest entity, services related to accounting and bookkeeping services, or <u>related to</u> financial information which forms the basis of the financial statements.”</p>
R601.7	<p>Accounting and Bookkeeping Services - Audit Clients that Are Public Interest Entities</p> <p>The reference to payroll services now only appears in section 601.4 A1 which sets out examples of accounting and bookkeeping services. We propose re-inserting the reference to payroll to re-align this section to the language in the extant Code:</p> <p>“A firm or a network firm shall not provide to an audit client that is a public interest entity accounting and bookkeeping services including <u>payroll services</u> or <u>the preparation of financial statements on which the firm.....</u>”</p>
R601.8	<p>Accounting and Bookkeeping Services - Audit Clients that Are Public Interest Entities</p> <p>We propose edits to align this exception to public interest entity audit clients and to re-insert the reference to payroll and preparation of financial statements to re-align this section to the language in the extant Code. The reference to R601.6 also requires an edit:</p> <p>“As an exception to paragraph R601. 76, a firm may provide accounting and bookkeeping services of <u>a routine or mechanical nature including payroll services and the preparation of financial statements of a routine or mechanical nature for divisions or....</u>”</p>
603.3 A2	<p>Valuation Services</p> <p>Suggested edit to add clarity:</p>

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	<p>“If a firm is requested to perform a valuation to assist an audit client with its tax reporting obligations or for tax planning purposes and the results of the valuation will not have a direct effect on the financial statements, the application material set out in paragraphs 604.12 A1–604.1A A1 relating to such services apply, <u>rather than the following provisions of 603 below</u>.”</p>
604.4 A2	<p>Taxation Services</p> <p>Section 290.179 of the extant Code contains the following assertion “providing such services does not usually create a threat to <u>independence if management takes responsibility for the returns including any significant judgements made</u>.” We propose that this factor be considered as a bullet in Section 604.4 A2.</p>
R606.5	<p>Information Technology Systems Services - Audit Clients That Are Not Public Interest Entities</p> <p>The following language in this section “unless appropriate policies and procedures are put in place ensuring that.....” would be more appropriately described as possible safeguards. A suggested edit would be:</p> <p>“Examples of actions that might be safeguards to address the threat created when providing IT systems services to an audit client that is not a public interest entity include putting in place appropriate policies and procedures ensuring that:.....”</p>

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Exposure Draft Reference	Comments
607.3 A1	<p>Litigation Support Services</p> <p>Section 290.202 of the extant Code refers only to “activities such as acting as expert witness” whereas the 2nd bullet of 607.3.A1 refers to “activities such as: Acting as a witness, including an expert witness”.</p> <p>We read the inclusion of the new language “acting as a witness” to situations where a member acts as a fact witness. We do not believe that acting as a fact witness to recount historic events poses any substantive threat to independence provided the testimony is limited to one of facts and suggest this language is either removed or further explanation provided.</p>
320.4 A1	<p>Professional Appointments</p> <p>We consider that the use of the word “might” in the following sentence appears inadequate when compared to the severity of the issues discussed.</p> <p style="padding-left: 40px;">“Issues that, if known, might create such threats include client involvement in illegal activities, dishonesty, questionable financial reporting practices or other unethical behavior.”</p>
320.6 A3, 320.6 A4	<p>Professional Appointments</p> <p>We consider that the following edit is required to reflect that this section properly relates to the general acceptance of a new audit engagement where there is an incumbent firm in place rather than to be read more widely to address situations such as where there has been a dismissal or resignation of a professional accountant.</p> <p style="padding-left: 40px;">“threats created by <u>accepting a</u> changes in professional appointment”</p>

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Exposure Draft Reference	Comments
340.4 A1 340.4 A2	<p>Gifts and Hospitality</p> <p>The meaning of the Code has been changed by inserting “or” between the two bullets. The use of the word “or” suggests that the threat would be lower if the gift or hospitality were made without the intent to influence. However, such an assertion would be difficult to demonstrate. To retain consistency with the extant Code we propose that the term “or” should be replace by “and”.</p>
911.6 A2	<p>Structure Phase 2 – Loans and Guarantees with an Assurance Client that is a Bank or Similar Institution</p> <p>We have suggested additional text to be added to the final sentence of section 911.6 A2 of the Structure exposure draft to align this section to the example safeguard in the extant code:</p> <p style="padding-left: 40px;">“If a loan from an assurance client that is a bank or similar institution is made under normal lending procedures, terms and conditions and it is material to the assurance client or firm receiving the loan, it might create a self-interest threat. An example of an action that might be a safeguard to address such threats is having the work reviewed by a professional who is not a member of the assurance team that is neither involved with the assurance engagement nor is a beneficiary of the loan. If the loan is to a firm, the reviewing professional might be someone from a network firm <u>that is neither involved with the assurance engagement nor is a beneficiary of the loan.</u>”</p>
950.5 A1	<p>Avoiding Management Responsibilities</p> <p>Section 950.5 addresses assuming a management responsibility as part of an assurance service. We consider the following edit is required to confirm the intent of 950.5.A1 as regards assuming such responsibility as part of a non- assurance service for an assurance client:</p>

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Exposure Draft Reference	Comments
	“Assuming a management responsibility as part of a <u>non-assurance</u> service <u>for an assurance client</u> creates self-review, self-interest and familiarity.”